Hot Topics in Super

Contribution Splitting – Brad Jeffrey

Transition to Retirement – John Ward

Benefit Projection – Darren Wickham

Contribution Splitting
– or income splitting comes to super

Brad Jeffrey

A Government promise delivered - partially

- Originally announced in *A better Superannuation System* in 2001

  "To assist families to maximise the benefits available in superannuation and to provide an avenue for spouses to share their superannuation benefits equally."

A Government promise delivered - partially

- Government commitment reaffirmed in *Superannuation for All and Understanding Many* in 2004

  "Superannuation splitting will allow contributions to be "split" or shared with a spouse. This will allow non-working or low income spouses to accumulate their own superannuation and give families more choices in how they prepare for their retirement."

A Government promise delivered - partially

But….

- Only applies to contributions paid after 1 January 2006
- Already accrued benefits cannot be split within superannuation – unless you divorce!
- Less useful to those now close to retirement possibly except where can maximise utilisation of maximum deductible limits

A Government promise delivered - partially

But….

- As usual – DB forgotten

  Splitting of Superannuation contributions between couples in 2002 said DB was currently excluded due to

  "additional complexities and issues in extending contribution splitting to defined benefit members with a defined benefit interest"

- Wasn't a barrier to surcharge tax!

So, what's all the fuss?

Splitting provides potential tax benefits by maximising access to:

- Two ETP low tax thresholds
- Two RBLs
- Two income streams and the low tax personal thresholds

It has been jumped on by the financial press and FP industry, so has high visibility.

But is it right for everyone?

- Perhaps not if you and your spouse will accumulate super over the low tax thresholds but under the RBLs (though it permits retirement income splitting)
- Not if it significantly increases costs
  – Initially, in the cost of making the split
  – Ongoing, will there be a doubling up on administration costs (particularly fix fee)

What do you need to consider?

- Trust Deed
- Communications
- Administration
- Death/TPD benefits
- Minimum requisite benefits
- Benefit guarantees
- Maximum deductible contribution limits

But back to DB Funds – what can we do?

- Hold out hope the Government will see the light?
  - 2006 model is different to 2002, but the Government hasn't realised this
- Or take action now
  - Change benefit designs to isolate/clarify/create accumulation interests

Consider a hybrid/greater of DB design

- On leaving before 55:

  Company (SG) Account

- On leaving after 55:

  Greater of:

  a) Company (SG) Account; and

  b) Defined Benefit of 12.5% x FAS x Membership

Turn it around

- On leaving at any time:

  Company (SG) Account

- If over 55:

  i. 12.5% x FAS x Membership, less

  ii. Company (SG) Account if positive

Therefore, you can split the 9% going to the purely accumulation Company (SG) Account.

But how?

Offset Account

- The amount split is debited to an Offset Account
- On leaving service in future, Offset Account is deducted from Company Account and also deducted from Defined Benefit
- It's a notional account (doesn't mean split contributions have to stay with the fund)

But what are the issues with doing so?

Offset Account issues

- Reduction in scope for utilising maximum deductible limits
- Communication to members – do you change design for all or just those who want to split?
- Is it legal?
- Additional costs (eg communication material, administration)

Transition to Retirement
- An aid to sensible retirement; or Yet another tax loophole

John Ward

An aid to sensible retirement

- Available to those over preservation age
- Can take a non-commutable pension whilst still working
- Not restricted to those who are working part-time
- Not compulsory for funds to offer
- Can apply to DB members

Rules

- Pension can be:
  - a complying pension (life-time, life expectancy or term allocated pension)
    - Locked in, cannot be commuted (limited exceptions)
  - A non-commutable allocated pension
    - More flexible, can be commuted back to growth phase at any time or commuted to cash after a cashing condition of release has been met

Work/life advantages for members

- Can work part-time and top-up income from pension
- Can ease into retirement by removing the sudden jump between full-time work and retirement
- Can gain access to some of preserved benefits to finance life style issues

Advantages for employers

- Provides means of:
  - Encouraging older employees to stay in workforce longer but on a part-time basis:
    - To train younger staff
    - To retain key skills and corporate knowledge
    - To minimise invalidity claims
  - Responding to staff shortages
  - Improving work-life balance
  - Reducing redundancies

Tax advantages for members

- Tax exemption for assets backing current pensions
- 15% tax rebate on pensions
- Can continue working full-time, take transition pension, and combine with significant extra salary sacrifice to super and contribution splitting
- Will it be used for tax or transitioning reasons?

Impact on accumulation funds

- Negligible
  - Members can transfer their balance to another fund which can provide a transition pension under portability rules
    - May result in loss of FUM
  - Fund can decide to offer pensions
    - Most large funds remaining post 30 June 2006 will offer retirement pension products (transition pensions only another small step)

Impact on DB arrangements

- Can be significant
- How can it be done
  - Reduction in accrued benefit multiple with defined benefits continuing to accrue
  - Offset account
  - Transfer to accumulation first

Reduction in accrued multiple

- Increases cost & AASB 119 impact
  - Expect accrued benefit to be paid earlier so loss of interest/salary increase differential
- What type of pension?
  - Trustees/employers unlikely to commit to defined benefit pension unless existing entitlements to such a pension
- Can member "buy back" accrued multiple by commuting allocated pension?

Offset account

- Could be cost neutral if interest rate on offset account = fund earning rate (impractical?)
- Other interest rate options include:
  - valuation rate;
  - a rate reflecting rates on fixed interest securities (treat as a quasi fixed interest investment?);
- Offset account could exceed eventual DB;
- Can member “buy back” DB by commuting pension?

Transfer to accumulation first

- Cost and accounting issues similar to reduction in accrued multiple
- Employer may be prepared to meet cost to hasten demise of its DB arrangements
  - Long term advantages eg avoiding AASB implications for DB funds
- Relatively simple – no going back

Considerations

- Trust Deed
- Communications
- Administration
- Death/TPD benefits
- Minimum requisite benefits
- Benefit guarantees
- Maximum deductible contribution limits
  - (if transfer to accum or used with splitting)

Calculators

Darren Wickham

Agenda

- Background
- ASIC Class Orders
- “Reasonable Assumptions”
- Other issues

Background

- GN 466 (October 04)
- ASIC Class Order 05/611 (superannuation, June 05)
- ASIC consultation paper (August 05)
- IAAust submission to ASIC (September 05)
- ASFA discussion paper/ proposed assumptions (September 2005)
- ASIC Class Order 05/1122 (generic, December 05)
- IFSA discussion paper (March 06)

ASIC Class Order 05/611 (superannuation)

- Provides exemption from need to hold financial services licence
- Or where licensed, exemption from conduct and disclosure provisions in part 7.7 of Act
- Relief applies when certain conditions met

Class Order 05/1122

- December 2005
- Revokes Class Order 05/ 611
- Applies to all calculators relating to all *“financial products”*, not just superannuation
- As per 05/611 – relief from need to hold licence, or for licensee, exemption from certain divisions of Part 7.7

Class Order 05/1122

Conditions:

- Does not promote products
- "If electronic device"
  - User can change assumptions other than ***statutory assumptions (tax, SG contribution rate)***
  - And perform calculations on basis of the changed assumptions
- Default assumptions (unless changed by user) are "reasonable"
- If "electronic" calculator - does not prevent printing or storing
- Keep copy of calculator for 7 years.

Class Order 05/1122

Must display

- Statement about purpose and limitations
- Explanation about why default assumptions are reasonable
- Explanation of the impact of limitations
- Statement whether or not estimate takes into account “the cost of living”
- Statement not to rely on for making decision and to seek advice.
- The statement must contain as much detail as a person would reasonably expect regarding nature of calculator

"Reasonable Assumptions"

- Information Release 05-32 (for class order 05/611) "Key Questions to consider":
  - Do assumptions match respected industry-wide sources including government and professional bodies?
  - Is the basis disclosed for the user's benefit?
  - Are settings regularly reviewed to keep them accurate and reasonable?
- ASIC August 05 consultation paper *"We expect the industry to develop its own guidelines"*
- Regulation Impact Statement (for CO 05/1122) refers to the costs involved which includes *"hiring actuaries, or other suitable professionals, to check the reasonableness of the default assumptions used by the calculator"*

"Reasonable Assumptions"

- ASFA discussion paper "Assumptions for Online Calculators" (refers to Sept 2002 IAAust SSC submission in relation to suggested investment assumption of 7.0% net of fees and taxes)
- SEBPC position – no specific guidance required, GN466 sufficient
- GN466
  - consistent / reasonable / realistic
  - AWE or salary based deflation preferred over CPI
- IAAust submission to ASIC – Government Actuary should set assumptions
- Draft IAAust response to ASFA
- IFSA discussion paper
- ASIC roundtable / stakeholder discussion proposed

Other Issues

- Product Specific Calculators (ASIC to consider "in the future")
- Printed Illustrations of future benefits
- ASIC calculators (super, allocated pension and risk profiler)
- Co – contributions, contribution splitting, transition to retirement.

Hot Topics in Super

Contribution Splitting – Brad Jeffrey

Transition to Retirement – John Ward

Benefit Projection – Darren Wickham