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7 June 2012

Subject: **Proposals Paper: Taxation relief to support the implementation of Stronger Super**

Dear Sir

We are pleased to have the opportunity to make a submission on this Proposals Paper. Relevant relief is critical in order for superannuation funds to create greater efficiencies by merging. We are aware of a number of situations in the last year where funds have decided not to merge due to the tax issues these proposals are intended to address.

Who is Mercer?

Mercer is a leading global provider of consulting, outsourcing and investment services, with more than 25,000 institutional clients worldwide. Mercer consultants help employers design and manage health, retirement and other benefits, and optimise human capital.

Mercer also provides customised administration, technology and total benefits outsourcing solutions to a large number of employer clients and superannuation funds (including industry funds, master trusts and employer sponsored superannuation funds). Mercer's outsourcing business has $55 billion in funds under administration locally, provides services to 1.3 million super fund members and 15,000 private clients and is part of a global consulting, outsourcing and investments firm which operates in 43 countries.

We operate our own master trust – the Mercer Super Trust – in Australia which has approximately 260 participating employers, 240,000 members and more than $15 billion in assets under management. Mercer's investment services include global leadership in investment consulting and multi-manager investment management. We also provide personal financial advisory services for individuals including Self Managed Superannuation Funds.

Executive Summary

Relief for merging funds

The relief is critical and welcomed.

Our major concerns relate to:

- the limited time period in which relief is available (we believe it should be ongoing if efficiency gains through merger activity are to be obtained)
- the lack of relief available for partial wind-ups (eg when a sub-fund of a master trust winds-up and members are transferred to another fund following an employer's decision to choose a more appropriate fund for its employees)
- the additional complexity resulting from the proposals in paragraph 4.1.3 (unless appropriate justification of why it is necessary can be provided)

Mandatory transfers to a MySuper in another fund

Whilst the proposed relief is also welcomed, we are concerned practical considerations will often make it difficult to utilise the relief. The Minister for Financial Services and Superannuation stated, in the Foreword to the Proposals Paper, "The taxation relief will also ensure that default members of superannuation funds are not adversely affected if their superannuation benefits and relevant assets are transferred under the MySuper reforms." The benefits referred to in his statement are unlikely to be realised in practice in some cases due to a number of practical difficulties.

We recommend, where members will be adversely affected because of issues relating to tax assets, APRA be given the power to defer any mandatory transfer until such time as those issues can be resolved.

We have also noted some instances where we believe the Proposals Paper needs further clarification.

More detail on the above comments is set out in the Appendix. Please contact me if you have any queries in relation to this submission.

Yours sincerely

John Ward
Manager, Research and Information

APPENDIX

PART 1: Relief for merging super funds:

Superannuation funds have sought greater efficiencies through mergers for many years. This will continue in future, both during the transition to MySuper and beyond. One of the main barriers to mergers and the resultant efficiencies has been the lack of tax rollover relief. A reintroduction of such relief is therefore welcomed.

Need for ongoing relief

We are concerned the relief is restricted to mergers in the period 1 June 2012 to 1 July 2017.

We acknowledge the Government has decided to only allow relief for this limited period however we believe:

- ongoing relief is critical for the ongoing evolution of an efficient system
- relief needs to be extended to partial wind-ups (eg where an employer sub-fund in a Master Trust winds up following a decision by the sponsoring to utilise a more appropriate fund for its employees. Another example relates to the sale of part of an employer group with the consequent transfer of members to the purchaser's superannuation fund. The lack of rollover relief in these circumstances is likely to result in members being adversely affected because of the tax outcomes)
- similar relief should also be generally available to SMSFs and small APRA funds to enable them to also merge without adverse tax consequences.

Additional complexity

The purpose behind the special provisions proposed in Section 4.1.3 of the Paper is not clearly explained in the Proposals Paper (other than a broad comment that it is an integrity measure). The added complexities resulting from the proposals in this section should be avoided unless there is clear evidence of potential abuses of the system. No such evidence has been provided in the Paper.

PART 2: Relief for mandatory transfers of members to a MySuper product in another fund

We welcome the provision of relief in such circumstances however, in many cases, we doubt it will be possible to utilise the relief due to practical considerations (see below).

Thus, the mandatory transfer requirements may result in members being adversely affected due to tax considerations, even if the rollover provisions are introduced. Of course, members might also be adversely impacted as a result of a mandatory transfer due to the possibility of higher fees, higher insurance premiums, lower insurance cover and different investment options in the receiving fund.

We note the Minister for Superannuation and Financial Services stated, in the Foreword to the Proposals Paper, "The taxation relief will also ensure that default members of superannuation funds are not adversely affected if their superannuation benefits and relevant assets are transferred under the MySuper reforms." As indicated above, the benefits referred to in this statement are unlikely to be realised due to these practical difficulties.

Nevertheless, there will be some circumstances where the proposed relief will operate successfully. In order to cater for those situations where the proposed relief does not provide the desired relief, we recommend APRA be given specific power to defer any mandatory transfer requirements.

Some of the practical difficulties referred to above are set out below:

Cost of utilising the relief

Trustees will incur costs in utilising the relief. It will presumably be necessary for negotiations between the transferring and receiving fund in relation to the transfer, (to agree on any assets to be transferred and the level of other tax assets to be transferred etc), agreements reached and signed with appropriate legal oversight.

Where the number of transferring members and related transfer values are not substantial, potential receiving funds may be unwilling to incur such costs. This leaves members of smaller funds (or funds where there are limited members in the default investment section) particularly vulnerable to a reduction in their account value on transfer.

Even for larger transfers, there are likely to be cases where the receiving fund will not be able to reflect the full value of the tax assets in members' accounts. This may lead to a reduction of the transferring members' account values in either the transferring or receiving fund.

Trustees may incur considerable costs in negotiating with a number of other funds in an effort to find an appropriate fund which is prepared to accept (and give full credit for) the transferring members' share of the tax losses.

Transfer of assets

Many funds are reluctant to accept assets other than cash when accepting a rollover payment or even a transfer amount in respect of a large number of transferring members. Even in fund merger situations, the receiving fund will generally not accept all of the transferring fund's existing assets, particularly where the assets are illiquid. There are many reasons why the receiving trustee may not accept existing assets including the assets being inconsistent with the receiving fund's investment strategy or liquidity policy, they may be too small to represent an efficient investment or there may be doubts on the value placed on any one asset.

It may not be possible to pass on full relief

If the transferring group is not a commercially attractive business proposition, the receiving fund may not be willing to accept a transfer value made up of cash and a notional tax asset, for example, $1,000 which is made up of cash of $970 and a tax asset (supposedly worth $30) or may only be prepared to give credit in transferring members' accounts for a value of tax assets of less than the transferred $30.

Issues for remaining members

Where a trustee is unable to find another fund willing to accept a transfer value other than one fully matched by cash or tangible assets, the trustee will presumably be forced to transfer cash (or tangible assets) only. The trustee is then likely to have little option but to reduce account values (to remove the value of tax assets) and transfer the remainder. Otherwise, if the unreduced account value is transferred, this is likely to adversely impact on remaining members as the remaining fund will be made up of a higher proportion of tax assets, with the possibility it will never be able to utilise all of them.

Other issues relating to proposals for mandatory transfers

Lack of ongoing relief

The limited window available for such relief is a concern. Funds may, from time to time, lose their authority to offer a MySuper product or may decide to cease offering such a product. Without ongoing relief, mandatory transfers in such circumstances will potentially be adversely affected by a lack of relief.

Lack of clarity

Several aspects of the Proposals Paper are unclear. These include:

- Will the relief apply if members subject to the mandatory transfer requirements are given the right to choose the fund to which they will be transferred? (For example, the trustee might have arranged a fund to accept default transfers but members are able to select an alternative fund.) Of course, practical considerations apply here – a receiving fund for an individual transfer is unlikely to be willing to accept tax assets as part of the transfer value
- It appears unlimited relief applies in respect of assets transferred to the receiving fund using the rollover option under which the receiving fund receives an asset and can utilise the original purchase date and cost value for determining its future tax liabilities. However, there appears to be a limit on the amount of tax losses which can be otherwise transferred up to the amount taken into account in determining the account balances. It is unclear how these two provisions interact.