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4 August 2017

Subject: **Housing-related superannuation measures: Consultation on draft legislation**

Dear Sir/Madam

Thank you for the opportunity to make comment on the draft legislation to establish a First Home Super Saver Scheme (FHSSS) and to allow a special 'downsizing' contribution into superannuation.

Mercer is supportive of both of these measures provided that (as is proposed in the draft material) they are largely administered by the Australian Taxation Office (ATO). Our comments on the draft material are set in Attachments 1 (FHSSS) and 2 (Downsizer Contributions)

Our main concern with the FHSSS as proposed is that the enhanced superannuation contributions reporting which underpins the administration of the FHSS by the ATO is still in planning stage and is unlikely to be fully up and running until well into the 2018/19 financial year at the earliest.

We are therefore concerned about the potential for costly interim workarounds (e.g. ad hoc requests from the ATO to funds for contributions information) during 2018/19 when the first releases can be requested. We request that:

- any such workarounds be designed in consultation with funds and be directed at minimising the additional work required of funds; and
- any ATO or other Government material should clearly communicate to potential FHSSS participants that longer timeframes for FHSSS determinations are likely to apply in 2018/19 due to the required reporting mechanisms not yet being in place.

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We are also concerned that applying FHSSS interest at the Shortfall Interest Charge rate would tacitly encourage risky investment behaviour and that this is reinforced by the comments in the Fact Sheet. We recommend that the rate be reduced to a level that is realistically achievable by a prudent investor and that the Fact Sheet and any other ATO material relating to the FHSSS draws attention to the risks of having superannuation monies the member intends to withdraw under the FHSSS invested in a long-term strategy.

### **Who is Mercer?**

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Mercer Australia 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). We have over \$150 billion in funds under administration locally and provide services to over 2.4 million superannuation members and 15,000 private clients. Our own master trust in Australia, the Mercer Super Trust, has around 230 participating employers, 224,000 members and more than \$21 billion in assets under management.

Please contact me on 03 9623 5464 or by email if you would like to discuss this submission.

Yours sincerely



**Dr David Knox**  
**Senior Partner**

## **Attachment 1: First Home Super Saver Scheme (FHSSS)**

### *1. Role of super funds*

On our reading of the exposure draft and related material the role of super funds in the FHSSS will be restricted to the following:

#### **(a) Providing information on the FHSSS to the extent considered necessary or appropriate**

- As a minimum it is likely to be considered necessary to include mention of the FHSSS in the fund's PDS as a consideration for members thinking about voluntary contributions and as a potential factor relevant to the suitability of the investment strategy; similar information on the website for existing members would also seem necessary (though 'promotion' of the FHSSS would presumably be voluntary)
- It is essential that detailed 'member-friendly' information on the FHSSS is readily available on the ATO website, so that funds can refer to this in relevant member communications material (including on-line) and in response to member queries.

#### **(b) Reporting contribution information**

- More detailed reporting of contribution information by funds is not required for 2017/18. We assume that for 2017/18 the ATO will determine voluntary member contributions from fund's Member Contributions Statements and voluntary employer/salary sacrifice contributions from employer reporting of Reportable Employer Superannuation Contributions (RESCs), which are both provided some time after year end.
- The draft legislation appears to assume that more detailed and frequent reporting will commence effective 1/7/18 as releases can be requested from 1/7/18 and the ATO is to calculate monthly deemed interest from then. This enhanced reporting is not covered in the draft legislation. We understand that under current plans the enhanced reporting will be phased in over the 12 months from 1/7/18 so workarounds are likely to be required during this period.

#### **(c) Complying with an FHSS release authority when received**

- This is restricted to paying the specified amount to the ATO (provided this is less than the maximum release amount, which is generally the member's account balance);
- We note the fund is not responsible for withholding tax and that the proportioning rule does not apply to these releases; as for other release authority payments the tax free component is not reduced even if the FHSSS amount includes an amount in respect of non-concessional contributions

**(d) Receiving a re-contribution if the member does not use the FHSSS money as required and wishes to avoid tax**

- We note there do not appear to be any requirements for the fund in relation to such a re-contribution; it is up to the member to lodge a form with the ATO and presumably the ATO will verify from the fund's normal contribution reporting that non-concessional contributions of at least the amount claimed have been made i.e. a re-contribution is just treated as a normal non-concessional contribution from the fund's viewpoint

We strongly support minimisation of the administrative role of the fund, including the ATO being responsible for the taxation of the released amount. **Please advise us if our understanding as set out above is not correct.**

Our main concern is the potential for costly interim workarounds (e.g. ad hoc requests from the ATO to funds for contributions information) during 2018/19 when the first releases can be requested (refer point (b) above). **We request that:**

- any such workarounds be designed in consultation with funds and be directed at minimising the additional work required of funds; and
- any ATO or other Government material should clearly communicate to potential FHSSS participants that longer timeframes for FHSSS determinations are likely to apply in 2018/19 due to the required reporting mechanisms not yet being in place.

Alternatively the date for the first release could be deferred 12 months.

## *2. Associated earnings rate*

We agree with the calculation of the 'associated earnings' using a notional earnings rate and notional payment dates. This is a practical approach that facilitates calculation by the ATO, which we strongly support.

However we take issue with the contention in the Fact Sheet that because historically super fund earnings have generally exceeded the Shortfall Interest Charge, this policy (calculating 'associated earnings' on FHSSS contributions using the Shortfall Interest Charge rate) would generally be expected to increase the funds remaining in super for individuals using the scheme.

This statement effectively assumes (and indirectly encourages) those utilising the FHSSS to take a risky approach with the investment strategy on the (notional) FHSSS component of their superannuation balance i.e. to 'let it ride' on the long-term investment strategy designed for their retirement savings, rather than to take the prudent approach of investing the portion of their account approximating the amount they intend to withdraw under the FHSSS in a short-term strategy designed to preserve their capital e.g. a heavily cash-based strategy.

We expect that trustee material relating to the FHSSS will draw attention to the risks that would be associated with investing contributions expected to be withdrawn in a short number of years in a strategy where capital values may fluctuate considerably.

Members are likely to earn much less than the Shortfall Interest Charge rate if they adopt a prudent strategy and so in these circumstances the FHSSS withdrawal is almost certain to reduce their retirement savings.

In our view setting the associated earnings rate at the Shortfall Interest Charge rate would tacitly encourage risky investment behaviour and this is reinforced by the comments in the Fact Sheet.

**We recommend that:**

- the rate be reduced to a level that is realistically achievable by a prudent investor; and
- the Fact Sheet and any other ATO material relating to the FHSSS draws attention to the risks of having superannuation monies the member intends to withdraw under the FHSSS invested in a long-term strategy, such that members may need to consider lower-risk strategies; if the associated earnings rate is not reduced to a level that is realistically achievable by a prudent investor, the material should also point out that lower risk strategies are likely to have returns that are lower than the associated earnings rate and hence their FHSSS withdrawal may reduce their retirement savings.

### *3. Defined benefit (DB) exclusion*

Under the draft, a 'contribution made in respect of a defined benefit interest' is not an eligible contribution for FHSSS.

We understand that this will mean neither of the following is eligible:

- a post-tax member contribution in respect of a DB interest; and
- a salary sacrifice contribution in respect of a DB interest.

We strongly support this exclusion as it would be inappropriate to allow removal of contributions funding a DB interest. However **we are unsure how the ATO will identify such ineligible contributions as:**

- DB salary sacrifice contributions will generally be reportable as RESCs unless the member has no option to pay the contributions post-tax – if the ATO is using RESCs to identify eligible contributions in 2017/18, how will it exclude those that are in respect of a DB interest?
- Where a member makes post-tax DB member contributions and also makes post-tax voluntary additional contributions to an accumulation account in the same fund, these are not currently split between DB and accumulation in fund reporting to the ATO via

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the Member Contributions Statement. Therefore how will the ATO be able to exclude those that are in respect of a DB interest?

There will also be a need to clarify the treatment of DB designs where the member is required to contribute (say 5%) to accrue a lump sum DB but the member contributions plus associated investment earnings are paid on top of the DB lump sum and are considered not to form part of the DB interest. These contributions also do not affect the funding of the defined benefits.

While these member contributions are generally not regarded as being 'to a defined benefit interest' they are arguably 'in respect of a defined benefit interest' as they are required as a condition of accruing the DB and allowing their release under the FHSSS would not be consistent with the fund design.

**We seek confirmation** that these member contributions would not be eligible for release under the FHSSS. If confirmed, we query how the ATO will identify such ineligible contributions.

#### *4. Reported SG contributions vs mandated contributions*

The draft legislation provides that any employer contributions that are not mandated contributions will be eligible under the FHSSS. Mandated contributions are essentially contributions that reduce an employer's potential liability for superannuation guarantee (SG) shortfall charge or that are required under an industrial agreement (such as an Enterprise Agreement) or award.

Whilst we agree this is a practical approach, we note that it is frequently the case that what employers pay and advise as 'SG' contributions are actually in excess of the minimum SG requirement e.g. the employer pays:

- 9.5% of a 'maximum cash' salary that exceeds the employee's ordinary time earnings (OTE) if the employee elects to take part of their remuneration in fringe benefits or salary sacrifice super contributions (under current legislation)
- 9.5% of the salary the employee would have received if they had not elected to make salary sacrifice super contributions (under current legislation)
- 9.5% of earnings for employees under age 18 who don't work more than 30 hours a week
- 9.5% of earnings for employees who earn less than \$450 in a month
- 9.5% of OTE not restricted to the maximum contributions base

We note that in the above situations the excess over the minimum SG amount would not be reportable as RESCs as the employee does not influence whether or not they are paid.

It appears that under the proposed legislation these contributions will be eligible for FHSSS but they will not be able to be identified.

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We believe that under SIS r 5.05 the trustee is required to treat the whole of these contribution as mandated contributions unless and until it is satisfied that they are not mandated contributions.

Clearly the trustee would rely on the information provided by the employer and neither of these parties will want to be under pressure from a member to re-classify and re-report part of an 'SG' contribution as non-mandated so it is treated as eligible for FHSSS.

**Is there a way to avoid this potential situation?**

## Attachment 2: Downsizer Contributions

### 1. *Option not to accept Downsizer contributions*

The explanatory material and the Fact Sheet indicate that it is not proposed to be compulsory for funds to accept Downsizer super contributions.

However we note that for MySuper products, SIS s29TC(f) requires that the only limitations imposed on the source or kind of contributions made by or on behalf of persons who hold a beneficial interest of that class in the fund are those permitted under s 29TC(3). SIS r 9.48 sets out permitted limitations which do not include downsizer contributions.

Accepting downsizer contributions would require changes to a fund's documentation, procedures and systems and, accordingly, will involve some increase in fund administration costs. Some funds may consider that only a small number of their members are likely to make downsizer contributions and that the additional benefit to these members would be outweighed by the increase in administration costs that would be borne by all members. For example an employer fund that does not offer pension products may see little value in facilitating Downsizer contributions that are predominantly aimed at non-workers aged over 65.

To give effect to the intended policy as indicated by the Fact Sheet and to allow funds the flexibility to decide not to accept downsizer contributions, **we recommend that** SIS r 9.48 be amended so that funds are not required to accept downsizer contributions for members with MySuper interests.

### 2. *Role of funds accepting Downsizer contributions*

Assuming a fund will accept Downsizer contributions, we understand its role will be:

**(a) Providing information on the Downsizer super contributions scheme to the extent considered necessary or appropriate**

- As a minimum it is likely to be considered necessary to include mention of Downsizer contributions in PDS material as an acceptable contribution
- Some information on the website for existing members would also seem necessary, with links to the ATO information page and/or the ATO Downsizer contribution form
- It is essential that detailed 'member-friendly' information on the Downsizer contribution scheme is readily available on the ATO website, so that funds can refer to this in relevant member communications material (including on-line) and in response to member queries.



**(b) Determining whether a contribution can be accepted as a downsizer contribution**

- The draft material says that in doing this ‘funds are not expected to undertake verification processes that are any more onerous than those that currently apply in determining whether a member satisfies a particular age or work test’.
- The draft requires a member to provide an ATO approved form to a fund in order to make a Downsizer contribution. It does not say whether or not the member must also provide a copy to the ATO.
- Nowadays almost all contributions are received electronically and processed automatically, so there will be a need to set up new processes to ensure the necessary forms are received and reviewed for Downsizer contributions and that the auto loaded contributions are then flagged and reported as Downsizer contributions or refunded if ineligible.
- Currently if a member is aged over 75, our systems are set up so that member contributions are blocked and won’t load; accepting Downsizer contributions would require removal of these blocks and design and implementation of system changes and administrative procedures to accept the contributions and then refund them if the Downsizer form has not been provided and/or any other verification checks are not satisfied.

**(c) Reporting contribution information**

- Downsizer contributions will have to be separately identified in ATO contribution reporting
- This will require changes to systems and processes, including a new contribution type for ATO reporting, possibly also special flagging or capturing on statements and for APRA reporting

**(d) Dealing appropriately with any contribution found not to be a Downsizer contribution**

- The ATO must notify the fund if it considers a contribution (presumably a contribution reported by the fund as a Downsizer contribution) does not meet the requirements of a Downsizer contribution
- The ATO may give a copy of the notification to APRA.
- The fund must then assess whether it could otherwise have accepted the contribution from the member based on their age or their working status:
  - (i) If yes, OK but the contribution will then count towards the individual's contribution caps, generally as a non-concessional contribution
  - (ii) If not, it must return the contribution under established protocols for dealing with contributions that cannot be accepted
- The fund will be required to re-report or amend any previous report to the ATO re the contribution – this is a significant issue as it would mean manual intervention and

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processing to make it count correctly and re-report to the ATO and ensure the refund is excluded from contribution reporting etc

In regard to (b), **we seek confirmation that** provision of the completed ATO form will constitute sufficient verification to the fund that the member is eligible (the fund would also need to check against its records the member is over age 65).

In regard to (d):

- We request consultation with the industry re how to make the re-reporting process as efficient as possible
- The draft material says it is also expected that if an APRA-regulated fund is aware that a Downsizer contribution that it received does not meet the definition of a Downsizer contribution “it must report this as a serious breach on its breach register”. **We seek confirmation this** would only be if the fund does not refund the contribution in accordance with the accepted protocols.

**Alternatively, we suggest** the member be required to have the ATO confirm their eligibility prior to making the contribution, with the period for making the contribution extended to allow for this extra step in the process. This would avoid the potential for ineligible Downsizer contributions and the accompanying burdensome administrative processes.