INSTITUTE OF FINANCIAL PROFESSIONALS AUSTRALIA

8 October 2024

Tax and Transfers Branch
Retirement Income and Superannuation Division
The Treasury
Langton Crescent
PARKES ACT 2600
superannaution@treasury.gov.au

Dear Sir/Madam,

Submission on legacy retirement product conversions and reserves – draft regulations

The Institute of Financial Professionals Australia (**IFPA**) welcomes the opportunity to provide this submission on the *Treasury Laws Amendment (Self-managed superannuation funds – legacy retirement product conversions and reserves) Regulations 2024* (**draft regulations**).

We applaud the government's draft regulations on allowing individuals to exit certain legacy retirement products and allowing more flexible pathways to make allocations from a reserve. This long-awaited measure will be helpful for both the SMSF sector and for retirees who have been trapped in non-commutable legacy pensions for years. While these regulations take an important step towards implementing this measure, we believe minor amendments should be made to the draft regulations to ensure this measure works in the most effective way.

For ease of reference, we have summarised our key recommendations below.

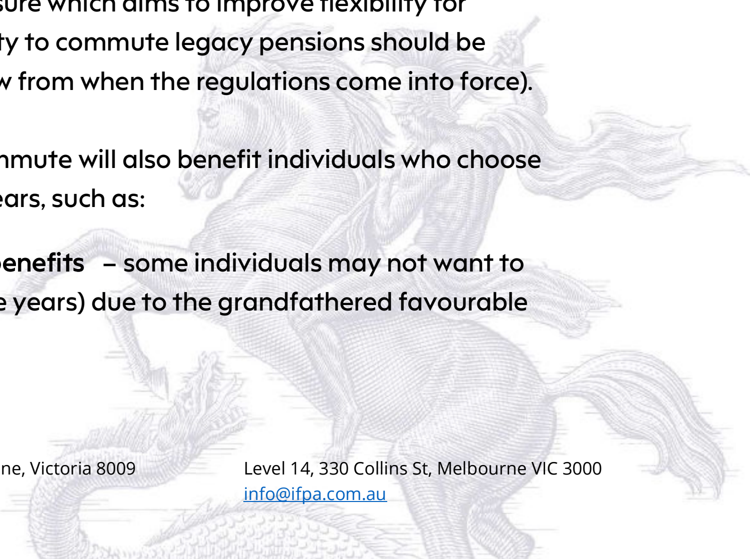
Note – for the purposes of this submission, we have referred to 'legacy retirement products' as 'legacy pensions' (unless stated otherwise).

1. Timeframe to commute should be ongoing

Although the timeframe to fully commute a legacy pension is an improvement to the initial proposal to commute within two years, we believe the new five year proposal is unnecessary and adds inflexibility to a measure which aims to improve flexibility for individuals. Accordingly, we believe the ability to commute legacy pensions should be ongoing (ie, not subject to a five year window from when the regulations come into force).

Having an unrestricted period of time to commute will also benefit individuals who choose to retain their legacy pension beyond five years, such as:

- **Individuals in receipt of social security benefits** – some individuals may not want to commute in the short term (ie, within five years) due to the grandfathered favourable



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social security concessions they receive from holding their legacy pension. However, if the five year window applies, they will be unable to exit their legacy pension at a time in the future where it no longer meets their circumstances (ie, if the social security concessions are no longer worthwhile) or they need liquidity (as discussed below).

- **Individuals who require liquidity** – circumstances may change in the future where an individual may need to commute their pension due to illiquidity outside of superannuation. For example, individuals may require extra liquidity and/or access to capital for a range of reasons, such as due to ill health, aged care, death, large one-off capital expenses in retirement, etc.
- **Individuals whose circumstances change** – similar to the previous point, an individual's circumstances may change in the future. They may be happy with their legacy pension now, but they may change their mind in the years ahead. For example, when the pension's capital value has become relatively small such that it is uneconomical for them to run an SMSF just for that pension. They could also become incapacitated such that it is preferrable for them not to remain in an SMSF and, therefore, the preference is for the pension to be commuted.
- **Individuals who become a reversionary beneficiary** – it may be decided in the future by a reversionary beneficiary that they do not want to receive the legacy pension upon the death of the original pensioner. This decision may differ from the original pensioner's view of wanting to retain the product. If the current five year time limit is to be retained, we recommend an indefinite period of time to commute if an individual receives the income stream as a reversionary beneficiary.

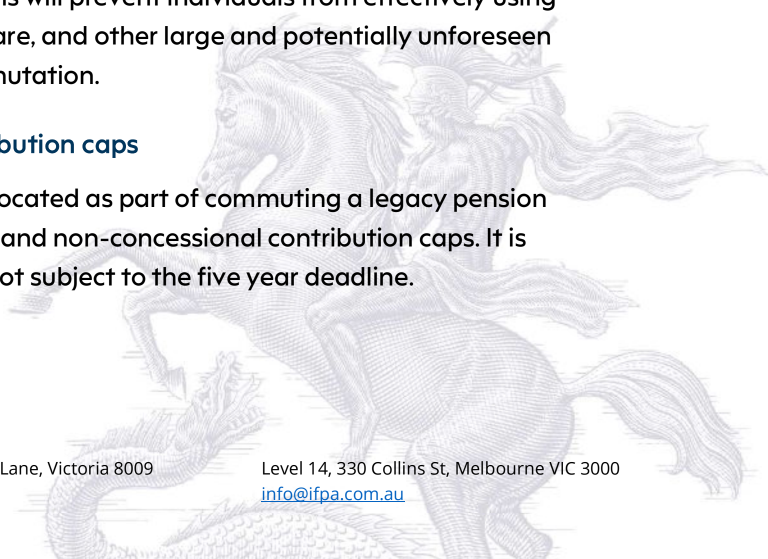
2. Allow partial commutations

We believe that individuals should also be allowed to partially commute from their legacy pension. It may be that the individual wants to retain their legacy pension but they require access to capital for a particular reason, or may want to commute a certain amount to remain below the defined benefit income cap (ie, $118,750 in 2024/25) so they don't have to pay additional taxation on income exceeding the cap.

Only allowing full commutations will restrict individuals who want to keep their legacy pension from making partial commutations and retaining a residual pension arrangement under the pre-existing rules. Specifically, this will prevent individuals from effectively using their retirement savings for health, aged care, and other large and potentially unforeseen expenses in retirement without a full commutation.

3. Exempt all reserve allocations from contribution caps

We welcome the proposal that reserves allocated as part of commuting a legacy pension will be exempt from both the concessional and non-concessional contribution caps. It is also encouraging that these reserves are not subject to the five year deadline.



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We also acknowledge that other large reserve allocations (ie, allocations more than 5%) will now count towards an individual's non-concessional contribution cap rather than their concessional contribution cap. While this is a positive announcement, we believe all reserve allocations (ie, not just reserves allocated as part of winding up a legacy pension) should be fully exempt from the contribution caps for a number of reasons, such as:

- **Reserves are scarce** – since the ATO's scrutiny into the use of reserves by SMSFs[1], there are hardly any reserves left due the difficultly in setting them up today.
- **Reserve allocations can lead to excess tax** – although the non-concessional contribution cap is generally larger than the concessional contribution cap, the non-concessional contribution cap is linked to the size of an individual's total superannuation balance. This means if an individual has more than $1.9 million at 30 June 2024, they will have a non-concessional contributions cap of nil for 2024/25. Likewise, for a member aged 75 or over, no non-concessional contributions can be made. If the individual's SMSF makes a large reserve allocation (ie, more than 5%), the entire reserve allocation would exceed the individual's non-concessional contribution cap which could lead to a large excess contribution tax liability.

For this reason, it would be beneficial for members who still have amounts in a reserve to be able to wind up the reserve account by allocating the entire amount out without having to factor in the non-concessional contribution cap. There is no mischief in wanting to wind up a reserve account that has been locked away for many years due to the current rules. Preferably, such measure would be a permanent change. Alternatively, this unlimited transfer would be for at least the five year period applying to the complying pension measure.

If the non-concessional cap measure is retained, we believe all members regardless of account balance (eg, if they exceed $1.9 million) or age (eg, if they are aged 75+) should be able to allocate reserves up to the value of the non-concessional contribution cap. So, for example, a member who is aged 79 and has a $2.3 million total superannuation balance could still receive an allocation from the reserve of $120,000 a year or $360,000 under the bring forward rule.

The proposals above would ensure that the few remaining reserves in SMSFs could be rapidly diminished in the coming years.

[1] SMSFRB 2018/1 – The use of reserves by self-managed superannuation funds, 15 March 2018

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4. Allow legacy pensions to be commuted in APRA-regulated funds

We also don't see why the measure necessarily needs to be restricted to SMSFs. In other words, we question why other legacy pensions, such as lifetime products offered by large APRA-regulated defined benefit schemes or public sector defined benefit schemes are excluded from this measure.

That said, as members of our association primarily look after clients that have SMSFs, we will leave it to industry bodies representing the large APRA-regulated fund sector to provide their views and make submissions on this matter.

5. Grandfather social security exemptions

We note that the 2021/22 Federal Budget Factsheet on 'Superannuation – More Flexibility for Older Australians' stated that the existing social security treatment that applies to the legacy product will not transition over for those who elect to take advantage of the conversion. This means any social security treatment the product carries such as 100% or 50% asset test exemption and/or grandfathering for income test purposes will cease upon commutation.

The factsheet also stated that there will be no re-assessment of the social security treatment the product received prior to the commutation. Fortunately, this means that individuals would not be required to pay back any overpaid entitlements.

However, we believe not retaining the existing social security treatment that applies to legacy pensions may be a reason why this measure won't be as successful as it could be because the loss of social security exemptions is a barrier to commute. As such, we propose that the existing social security exemption should be grandfathered for affected individuals, if possible.

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Closing comments

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Yours faithfully,

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IFPA Board Member
Chair, Superannuation Technical and Policy Committee

Natasha Panagis
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About the Institute of Financial Professionals Australia

The Institute of Financial Professionals Australia (IFPA) is a not-for-profit membership association (originally known as Taxpayers Australia, then more recently Tax & Super Australia) and has been serving members for over 100 years. With a membership and subscriber base of over 15,000 practitioners, our association is at the forefront of educating and advocating on behalf of independent tax, superannuation and financial services professionals. This submission is made by us on behalf of our members' interests.