



TREASURER



NO.

EMBARGO 20 August 1996 7:30pm AEST

RETIREMENT SAVINGS ACCOUNTS

The Government has decided to allow banks, building societies, credit unions and life insurance companies (life offices) to provide superannuation without a trust structure in the form of Retirement Savings Accounts (RSAs). RSAs will be required to be 'capital guaranteed'. The accounts, into which a member and/or an employer on the member's behalf will be able to make deposits, will be fully portable, owned and controlled by the member, and subject to the retirement income standards of superannuation products, including preservation. RSAs will also be able to accept superannuation contributions on behalf of non-working and low income spouses.

RSAs will be a simple, low cost, low risk product especially suited to those with small amounts of superannuation, such as itinerant and casual workers, those wishing to amalgamate several small superannuation accounts and those nearing retirement (wishing to minimise risk). Their introduction will complement existing arrangements by increasing competition and choice in the superannuation industry, thereby putting downward pressure on fees and charges, and encouraging better standards of service.

The provision of RSAs will benefit employers looking for a convenient superannuation vehicle for small contributions under the Superannuation Guarantee arrangements. Many employees will also benefit — such as those with broken work patterns, a particular problem for women, and itinerant employees — as RSAs will provide a flexible product to accommodate small and irregular contributions. Fees should also be low and the accounts will be subject to the member protection rules which apply to accounts with small balances (less than \$1000).

RSA providers will benefit from being able to offer cost-efficient delivery of superannuation and the ability to use more explicitly the institutions' name in marketing superannuation, as well as from enhanced customer relationships through provision of one stop shop services.

It is expected that RSAs will yield relatively modest returns, reflecting their 'capital guaranteed' nature. It will be mandatory, therefore, for RSA providers to advise account holders of alternative 'balanced portfolio' products offering potentially higher returns over the longer term, when their account balances reach \$10,000. However, there will be no restriction on RSA balances exceeding this limit. The Government wishes to ensure that people's retirement incomes are maximised but recognises that for some people, RSAs may be the appropriate choice, particularly those close to retirement who may prefer a minimal risk savings vehicle. To that end, RSAs will be available as rollover vehicles.

The supervision of RSAs will consist of the relevant prudential supervision for institutional soundness, and functional supervision by the Insurance and Superannuation Commission (ISC) for compliance with retirement income and other superannuation standards.

RSAs will be subject to the following arrangements:

- a) banks, building societies, credit unions and life offices will be able to offer RSAs without a trust structure;
- b) all RSAs will be required to be 'capital guaranteed';
- c) RSAs will form part of the deposit base of deposit taking financial institutions (banks, building societies and credit unions) and will be treated as such for prudential purposes by the Reserve Bank of Australia and the Australian Financial Institutions Commission;
- d) public offer, complying superannuation funds will continue to operate under a trust structure as at present, and will be free to offer superannuation products broadly equivalent in nature to an RSA if they so wish;
- e) the disclosure regimes applying to RSAs will be finalised in consultation with industry representatives, but are expected to be very similar to those applying to other forms of superannuation;
- f) member benefits in RSAs will be fully portable;
- g) RSAs will only be permitted to be opened and maintained by, or on behalf of, individual beneficiaries. That is, employers may open individual RSAs in the name of their employees to meet Superannuation Guarantee obligations, but will not be permitted to prevent members transferring funds from their RSA to an alternative complying superannuation fund;
- h) deposit taking institutions will be restricted to providing benefits in a form which does not involve mortality risk (that is, they could not offer traditional pensions). Such RSAs will be able to be paid out as lump sums or allocated pensions. RSAs offered by life offices will not face this restriction and could provide benefits in the form of an ordinary pension or annuity;
- i) all RSA benefits will be subject to preservation rules which are fully consistent with those that apply to other types of superannuation funds;
- j) the taxation treatment of bank, building society, credit union and life office RSAs will be as follows:
 - i) in calculating the taxable income of the financial institution on RSA business, the assessable income will include all earnings made from RSA funds. Allowable deductions will include amounts actually credited to RSA accounts by the institution, such as interest paid, and any expenses incurred in undertaking RSA business. In determining the assessable income on earnings from RSA funds, an ordinary income rather than capital gains tax treatment will apply;
 - ii) the financial institution's taxable income from RSA business would be assessed at the normal tax rate applying to the financial institution (for example, the company tax rate for a bank or building society);
 - iii) employer contributions and other deductible contributions paid into RSAs, as well as untaxed amounts rolled over into RSAs, will be subject to the 15 per cent contributions tax (as well as a surcharge of up to 15 per cent which will apply to all deductible

superannuation contributions for higher income earners) to be withheld by the RSA provider;

- iv) net investment earnings credited to RSAs will be subject to the 15 per cent tax, payable by the RSA provider;
- v) withdrawals will be subject to the same taxation treatment as applying to funded superannuation payments generally;
- vi) requirements to prevent tax avoidance through RSAs will apply;
- k) the present tax treatment for public offer, complying superannuation funds will be unaffected; and
- l) RSA providers will be allowed to include life and disability cover, subject to existing prudential requirements.

Further details on these matters are contained in the attachment to this statement. The Government is committed to consulting with interested parties, and the Assistant Treasurer will be responsible for finalising the details of requirements that will apply to RSAs. Accordingly, the Government invites interested parties to make written submissions on these arrangements by 4 October 1996.

Submissions should be addressed to The First Assistant Secretary, Financial Institutions Division, The Treasury, Parkes Place, Parkes, ACT 2600.

Subject to the necessary legislative amendments, it is expected that approved financial institutions will be permitted to offer RSAs from 1 July 1997.

CANBERRA
20 August 1996

ARRANGEMENTS TO APPLY TO RSAs

REGULATORY REGIME TO APPLY TO RSA PROVIDERS

The supervision of RSAs can be split into two parts: relevant prudential supervision for institutional soundness, and functional supervision by the Insurance and Superannuation Commission (ISC) for compliance with retirement income and other superannuation standards.

Prudential Supervision of RSA Providers

Banks are required to operate within a prudential framework which covers, among others, minimum capital requirements and liquidity management. Banks are prudentially supervised by the Reserve Bank of Australia under the *Banking Act 1959*. Contributions to bank RSAs will become part of the bank's deposit base and balance sheet, and subject to the present prudential framework applying to its other business.

For building societies and credit unions, contributions to RSAs will also be part of the deposit base and balance sheet, and will be subject to State based supervision by the Australian Financial Institutions Commission (AFIC). (The eligibility of friendly societies to offer RSAs will be reviewed when they come under AFIC supervision.) Minimum operating standards for these institutions are broadly similar to those applying to banks. The RSA business of building societies and credit unions will be subject to the present prudential framework applying to their other business.

Contributions to life office RSAs will be channelled directly to a life office statutory fund and be subject to ISC supervision under the *Life Insurance Act 1995*. Life offices are required to meet capital adequacy and other appropriate prudential standards, although on a different basis to those applying to banks, reflecting the different nature of the industry. The RSA business of life offices will be subject to the present prudential framework applying to their other business.

Complying superannuation funds operate under a trust structure, and are supervised by the ISC under the *Superannuation Industry (Supervision) Act 1993* (SIS Act). These arrangements will continue and will permit public offer complying superannuation funds to offer products broadly equivalent to an RSA if they so wish.

Retirement Income and Non-Prudential Superannuation Standards

RSAs will generally be required to comply with retirement income and other non-prudential superannuation standards currently outlined in the SIS Act, income tax legislation and so on. These rules are detailed and the proposed treatment is outlined below. New legislation will be required to give effect to these measures.

Contributions

Employers will be able to open an RSA to accept Superannuation Guarantee (SG) contributions for an employee, but the account is to be held in the name of the employee, and the employer will not be allowed to prevent the employee from transferring the balance to another RSA or superannuation product.

The contributions rules for all superannuation funds will be amended to allow contributions on behalf of spouses without a link to the workforce. From 1997-98, there will be a rebate of 18 per cent for superannuation contributions of up to \$3,000 per annum made by income earning individuals to the superannuation fund or RSA of a spouse with an income below \$10,800 a year.

Investment Restrictions

Complying superannuation funds and life offices are not permitted to borrow (except for up to 90 days for short term cash flow management), or to lend money to, or acquire certain assets from, members of a fund. It would not be appropriate or practicable for banks, building societies or credit unions to be subject to these restrictions because RSAs will not be segregated from other borrowing and lending activities of the institution. These rules will still continue to be relevant for RSAs provided by life offices.

The prohibition on funds allowing members to secure borrowings against their superannuation benefits will apply to RSAs. Institutions will not be permitted to make loans to RSA account holders secured against assets in an RSA account. RSAs offered by banks will not be permitted to be subject to any account combination arrangements or interest offsetting arrangements. Nor will RSAs be permitted to be subject to any restrictions on portability.

RSA Returns and Investment Rules

All RSAs will be required to be 'capital guaranteed'. (This is a guarantee by the institution that the member's capital and any interest/returns credited to the member's account cannot be subsequently eroded by negative investment returns, either to existing accounts or on withdrawal.)

Because of this capital guarantee, RSAs may yield relatively modest returns, reflecting their low risk nature. 'Balanced portfolio' products would offer potentially higher returns over longer periods of time. Investors need to be aware of the relative attributes of different forms of superannuation product and the importance of maximising returns over the longer term.

To ensure that investors are aware of the returns on RSAs and can compare them to other products, RSA providers will be required to report returns to account holders on a similar basis to other superannuation products, rather than use a standard bank statement. In addition, the low risk/low return nature of an RSA will need to be adequately drawn to the investor's attention at the time an account is opened. The nature of the disclosure requirements applying to RSAs will be subject to further consultation.

Addressing the Expected Lower Returns from RSAs

As RSAs may yield lower returns than available from other superannuation products over the longer term, end benefits provided by RSAs may often be lower than provided by 'balanced portfolio' superannuation vehicles.

Accordingly the institution providing the RSA will be required to advise the account holder to assess alternative higher yielding superannuation investment opportunities when an RSA account balance reaches \$10,000. The nature of this advice will be the subject of consultation.

Tax File Number Reporting

Proposed amendments to the *Income Tax Assessment Act 1936* will permit superannuation funds to collect Tax File Number (TFN) particulars from members and will enable TFNs to be passed between funds on the transfer of members' benefits and to the Commissioner of Taxation. To ensure RSA accumulated amounts can be readily transferred to and from superannuation funds, and that RSA account holders can be identified, TFN reporting provisions will also apply to RSAs on the same voluntary basis as for other transactions.

Benefit Payment Rules/ Preservation /Vesting

Benefit payments will be subject to the same tax treatment and Reasonable Benefit Limits that apply to existing superannuation payments, including the related record keeping requirements. Further, the same conditions of early release (such as in cases of financial hardship, or permanent departure overseas) will also apply. These rules are currently contained in the SIS Act and Income Tax legislation. Preservation and vesting rules for amounts paid into RSAs will be fully consistent with those which apply to other types of superannuation funds.

Deposit taking institutions which provide RSAs will be permitted to pay RSA benefits in the form of allocated pensions and lump sums only. The provision of ordinary pensions would be problematic as this would mean that banks, building societies and credit unions would be accepting mortality risk (for example, the risk of having to pay out a life pension greater than the value of the accumulated contribution and earnings if, say, beneficiaries live longer than expected). Taking such risk is not readily compatible with the nature of a deposit taking institution. RSAs offered by life offices will not face this restriction and could provide benefits in the form of an ordinary pension or annuity.

Disclosure/ Member Reporting Requirements

An appropriate information disclosure regime will be set out in legislation or in an ISC determination enabled by legislation.

Any departures from the existing superannuation disclosure regime will require very careful consideration. Ongoing disclosure will cover contact information, annual account balance and amount deposited, annual and historic earnings/crediting rates and fees and charges. RSA providers will also have to give prospective depositors sufficient 'point of sale' information to understand the main features and benefits of the RSA, including fees and charges, the low risk nature of the product, and an indication that account holders have the right to request further information.

Registering of RSA Providers

RSA providers will not need to be licensed under the Corporations Law, as they are covered by alternative arrangements. This is provided there is appropriate point of sale disclosure and the RSA is sold by the institution's employees and not by an agent on the institution's behalf. These issues will be dealt with in the disclosure regime to be put in place by the ISC. It is proposed, however, that all RSA providers meet at least the capital adequacy requirements applying to a public offer, complying superannuation fund, namely that the custodian of fund assets must have minimum net tangible assets of at least \$5 million. An authorisation process undertaken by the ISC will be necessary. This process will include an assessment that the institution's proposed systems and staff training will be adequate to ensure compliance with retirement income and other superannuation standards.

Member Protection Rules for Small Amounts

RSAs will be subject to the ‘member protection’ rules in the SIS legislation, for amounts less than \$1000. For such amounts, fees and charges are not normally permitted to exceed interest credited to the account (the main exception is life insurance premiums). RSAs should provide investors with the same protection in this regard as public offer superannuation funds.

Portability/ Choice of Fund

Funds in RSAs will be required to be fully portable (subject to any fixed term for interest payments on the deposit account). That is, an RSA provider will be required to transfer part or all of an account balance to another RSA or superannuation fund at the account holder’s request. Such money will remain subject to preservation rules.

Complaints Handling

It is desirable to have a uniform approach to complaints handling for RSAs. In addition, the mechanisms for dealing with complaints about RSAs should be efficient and easily understood by all parties. The present diversity of dispute resolution schemes covering proposed RSA providers makes this problematic, and in the case of building societies, the scheme is only in the early stage of development.

It is therefore proposed that all superannuation products will be subject to the existing complaint processes for public offer superannuation funds. This would bring RSAs under the jurisdiction of the Superannuation Complaints Tribunal (SCT).

Responsible Entity and Penalties

A key feature of the SIS regime is that every regulated superannuation fund must have a ‘responsible entity’ - that is a trustee - who is primarily responsible for the viability and prudent operation of the fund. The ‘responsible entity’ concept ensures that trustees are fully accountable for any discretionary benefit payments made by the fund (for example, death and disability benefits) and are clearly liable for any gross negligence or intentional or reckless non-compliance with the SIS standards. This framework of accountability is enhanced by the requirement for equal numbers of employer and employee representatives on the trustee boards of employer-sponsored funds and for ISC approval of trustees of public offer superannuation funds.

To the extent that RSAs provide ancillary benefits to members, there will need to be a responsible entity to make decisions about whether to pay such benefits in particular instances, and also to take responsibility for ensuring that the SIS retirement income standards are complied with more generally.

There are a number of possibilities as to how this can be achieved and these will be the subject of consultation.

Given the public offer nature of RSAs there will be no requirement for equal representation on the ‘responsible entity’ of the RSA provider. New entrants will be required to register with the ISC, and providers required to report annually, amongst other information, the names of the relevant directors and to certify compliance with the SIS retirement income standards (including that a compliance and financial audit had been undertaken by an approved external auditor).

The ISC will recoup the costs of regulating RSAs through an annual levy on institutions offering RSAs. The annual levy will be comparable to the existing levy imposed on superannuation funds (currently a basic levy of \$200 for each \$500,000 in a fund, up to a maximum levy of \$14,000). The exact details will be finalised in consultation with industry.

Life and disability insurance

RSA providers will be permitted to offer life and disability insurance to RSA account holders subject to existing prudential requirements.

TAXATION TREATMENT OF RETIREMENT SAVINGS ACCOUNTS

The taxation of RSAs within any financial institution will involve two steps.

Step One

The first step is to calculate the taxable income of the financial institution as follows:

- a) **Assessable income**, which will include all earnings generated from RSA funds, including any fees derived from RSA account holders, **less**:
- b) **Allowable deductions**, which will include all amounts actually credited (as opposed to amounts accrued at a particular date) to each individual's RSA account during the financial year and any expenses incurred by the financial institution in undertaking RSA business.

This process will generate a similar taxable income for RSA business to that arising for a deposit taking financial institution on ordinary deposit business. It will ensure that the financial institution is assessed at its relevant rate on its profit margin from operating RSA deposits, but not on the investment earnings credited to RSAs.

In determining the assessable income on earnings from RSA funds, an ordinary income rather than capital gains tax treatment will apply.

However, the rate of tax that will apply to the taxable income from RSA business will vary as it is governed by the 'normal' tax rate applying to the type of financial institutions offering the account. The tax rates are:

- a) for a bank, building society, large credit union and non-mutual life office - the general company tax rate (a large credit union is one defined in the tax legislation to generate notional taxable income higher than \$150,000 per annum);
- b) for medium and small credit unions more generous taxation rates apply (though such credit unions may not qualify to register for RSA business if they do not satisfy the capital adequacy requirements);
- c) for a mutual life office - 39 per cent.

Step Two

The second step is to tax the RSA, in the same manner as a superannuation fund, on contributions and investment income (net of expenses). For practical reasons, this taxation would need to be

withheld by the financial institution on behalf of the individual account holder. That is, the financial institution would credit a periodic payment (net of expenses) to the RSA account but withhold tax, which it would remit to the Australian Taxation Office. It would also remit tax from 'deductible contributions' made to RSAs.

This approach assumes that the financial institution would credit RSA accounts with returns net of expenses. However, it would be possible for the financial institution to credit gross returns and debit the RSA account with fees to cover expenses. In this case the fees would be deductible in determining the tax liability of the RSA account holder in step two, and the fees must be reflected in the assessable income of the financial institution in step one.

Example of the Taxation of RSA Business

Assumptions

On the first day of its year of income, an eligible financial institution receives contributions for its RSA business of \$300,000, comprising deductible contributions of \$100,000 and non-deductible contributions of \$200,000. It invests or on-lends this money for a 10 per cent per annum return and incurs expenses of \$5,000. It credits RSA account holders with a net pre-tax return of \$20,000.

Step One Tax - Taxable Income of the Financial Institution from RSA business

Assessable Income	less Allowable Deductions	= Taxable Income
\$30,000 (interest income) = \$300,000 @ 10 per cent	\$ 5,000 (RSA expenses) \$20,000 (net interest credit)	\$5,000

Step Two Tax - Tax withheld on behalf of RSA account holders

Amount subject to Withholding Tax	Tax to be withheld
\$100,000 (Deductible Contributions)	tax @ 15 per cent (with a surcharge of up to 15 per cent for deductible contributions made by higher income earners)
\$ 20,000 (net interest credit)	tax @ 15 per cent

Taxation Treatment of RSA Account Holders

At the time that an RSA account holder withdraws money from an RSA account, the individual should receive the same tax treatment as a person receiving an Eligible Termination Payment (ETP) or an allocated pension. This will require the financial institution to keep records in relation to each RSA account holder of the undeducted contributions, and of the eligible service period in relation to ETPs that are rolled into RSAs, so as to provide the necessary information to enable the account holder to calculate the rate of tax applicable to each component of the amount withdrawn.