



AUSTRALIAN BANKERS' ASSOCIATION INC.

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Mr Michael Lim
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Dear Mr Lim,

Product rationalisation

The Australian Bankers' Association (ABA) welcomes the opportunity to provide comments on the Federal Government's *Product Rationalisation of Managed Investment Schemes and Life Insurance Products Proposals Paper*.

1. Opening remarks

The ABA believes that it is important that the law enables the financial services industry to more easily update the technology underpinning products and to introduce a simplified and sustainable process to enable customers to be shifted from outdated products to more suitable products, without financial detriment to the customer. The maintenance of outdated products is expensive and inefficient.

1.1 Background

The ABA believes that product rationalisation in the managed funds sector is needed due to changes in technology and commercial practices as well as legislative, regulatory and tax changes, resulting in products becoming outdated and making products more expensive to administer. Because of the nature and duration of life insurance and superannuation products and the many regulatory and tax changes subject to these products, life companies and superannuation entities particularly need a mechanism to rationalise their products. Outdated products can be costly and risky for consumers and product providers. Therefore, we urge the Federal Government to also consider product rationalisation for superannuation products as well as other financial products.

The ABA believes that product rationalisation should deliver a number of benefits for consumers and product providers, including enhanced competitiveness, improved disclosure, reduced operational risk and improved administration, reduced costs and improved service levels and innovative investment opportunities.

Therefore, it is the ABA's view is that product rationalisation should achieve objectives, including:

- A permanent and ongoing process that enables the transfer of consumers, members and policyholders from outdated products via an efficient, cost-effective and practical mechanism to a modern equivalent product. Product rationalisation should be consistent, to the extent appropriate, across managed investment and life insurance products (and superannuation and other financial products), to facilitate transparency for consumers and simplify processes for product providers.
- Consumers receive financial products with equivalent benefits and/or compensation.
- Consumers and product providers do not suffer adverse tax consequences. Product rationalisation should be tax neutral, including capital gains, income tax and stamp duty laws.
- Product providers are provided with certainty that transfers cannot be contested after completion. Responsibility for the initiation and conduct of a product rationalisation should be with the responsible entity or company, which should have regard for the interests of its consumers, i.e. the class of consumers as a whole. The responsible entity or company should ensure that the consumer is moved to a more suitable product or products without material financial detriment.
- Regulators are provided with appropriate powers to supervise product rationalisation proposals and processes, as well as to intervene in cases where misconduct is apparent.

1.2 Superannuation products

The ABA notes that the proposals paper outlines that product rationalisation will be implemented in stages. Stage 1 will deal with managed investment and life insurance products. Superannuation products have been excluded from Stage 1 based on the assumption that superannuation products have rationalisation rules under the successor fund transfer (SFT) provisions. However, there is no specific relief for SFT under the taxation legislation and SFT is not designed for rationalisation of the products within a superannuation fund, rather to allow the merger of multiple superannuation funds.

The ABA believes that a product rationalisation mechanism for superannuation products should also be implemented. Notwithstanding, without limited extension within a superannuation context, life annuities will be excluded, and therefore opportunities to utilise product rationalisation will be much more limited.

Therefore, the ABA believes that the product rationalisation regime should:

- Enable rationalisation between different types of superannuation products and transfer of superannuation members from a legacy product to an equivalent modern product;
- Allow life companies to transfer life policies which contain superannuation style/taxed assets into public offer superannuation funds. Equivalent member benefits and/or compensation should address transfer requirements; and
- Ensure a consistent set of rules apply across the rationalisation of different types of financial products which address legislative barriers, such as taxation.

The ABA believes that pending consideration of product rationalisation for superannuation products, the Federal Government should make improvements to the SFT provisions, such as extending or making permanent the CGT taxation relief (which is due to expire on 30 June 2011) and providing additional certainty around the 'equivalent benefits' standard.

Furthermore, the Federal Government should give consideration to other financial products that may be outdated and identify appropriate mechanisms for rationalisation of these legacy products.

2. Specific comments

2.1 Legacy product test

The ABA supports a "legacy product test" that establishes a set of criteria to ensure that only genuine outdated products are allowed to benefit from the product rationalisation mechanism. We consider that the criteria and tests should seek to remove economically inefficient products – that is, products that are outdated due to changes in the regulatory regime or products that are outdated because technology and administrative systems have changed. A product rationalisation mechanism should enable consumers to rollover their investment into a more efficient and modern product.

However, the ABA believes that the proposed legacy product test is not flexible enough. For example, the criteria significantly relies on historical data, yet due to past merger and acquisition activity, data may not be readily available.

Therefore, the ABA believes that the legacy product test should provide the following:

- Where a financial product has been closed to new members for at least 5 years, this product should be eligible for product rationalisation without further need to satisfy any criteria; or
- Where a financial product has been closed to new members for at least 2 years, there should be a case for product rationalisation subject to the criteria; or
- Where classes of product could be classified as legacy products by regulation or class order, such as deferred annuities, such products should be eligible for product rationalisation without further need to satisfy any criteria.

The ABA supports the Investment and Financial Services Association (IFSA) recommended approach to the proposed criteria and tests for outdated and unviable products.

2.2 Taxation relief test

The ABA believes that treatment of taxation is critical for any proposed product rationalisation mechanism. Therefore, we consider that where the requirements or criteria for a product rationalisation have been met, then rollover tax relief should automatically be available. While product providers may believe that a tax ruling is appropriate in certain circumstances, an application for a tax ruling should not be necessary. In the absence of tax relief, it would be virtually impossible for a proposed rationalisation to qualify pursuant to the "no disadvantage test". Therefore, we consider that if time requirements and criteria are to be included in taxation laws, then these requirements should be aligned with those contained in the product rationalisation mechanism.

The ABA believes that CGT rollover relief should apply at the asset level. In practice, this will mean that no capital gains tax liability will arise with the transfer of underlying assets of the product being rationalised. Furthermore, the transfer of tax attributes should accompany the transfer of the assets to the new entity.

The ABA believes that rollover tax relief should be provided in a manner that recognises that some underlying investment assets are not held on capital account, such as deposits, bonds, fixed interest securities, which may be held on revenue account. Relief should reconcile differences in account treatment – that is, there should be automatic rollover tax relief for these assets. Rollover tax relief would require suspension of certain provisions of the tax laws in a product rationalisation.

The ABA believes that taxation relief should also ensure that there is no tax liability at the investor level. In practice, this will mean that the tax attributes should accompany the transfer of the assets and continue post-rationalisation until the investor redeems their investment. The tax rules should operate on redemption as if the investor retained their original investment.

The ABA believes that where a rationalisation involves an insurance policy, the rationalisation should not result in the holding period for the purposes of calculating future tax liabilities to be re-set. We consider that transfer of a life insurance policy should be provided in a manner that means that tax provisions are not triggered and the holding period would reflect the time the investment was held within both the original and new entity.

The ABA believes that the State Governments should introduce provisions in the relevant stamp duties legislations to grant rollover tax relief for product rationalisations. Where the underlying investment asset being transferred is land/property or shares in an unlisted company, stamp duty will generally be levied. (We note that some States have exempt shares in an unlisted company from stamp duty provisions.) Furthermore, some States levy stamp duty on life insurance premiums.

The ABA believes that it is essential for the Federal Government and the ATO to provide legal clarity and certainty with regards to the application of taxation to the process of product rationalisation. It is our view that tax relief and/or administrative orders providing CGT rollover relief and clarifying the law is not a matter for consideration in terms of government revenue. We note that product rationalisations are not happening now because of taxation and other barriers, and therefore there is no existing revenue that would be forgone.

2.3 No disadvantage test

The ABA supports a “no disadvantage test” requiring that consumers, members or policyholders will be no worse off as a result of a product rationalisation transfer. However, we consider that a product provider should demonstrate that there will be no financial detriment to a class or classes of consumers, members or policyholders. The proposal to require a product provider to demonstrate that there will be no detriment to an individual will impose a substantially onerous obligation which in practice would be virtually impossible to administer or achieve.

The ABA believes that the product provider should ensure that the rationalisation is in the interests of the class of consumers and that consumers have equivalent benefits in the new product or products. We recognise that a product provider should take account of factors, including features, rights and benefits of the outdated product, such as fees and charges, taxes, insurances, unit pricing/valuation, investment strategy, services (online access), transaction costs, transaction rights (application, withdrawal, other), benefits (existing, future), etc.

However, the ABA does not support a “no disadvantage test” that requires the replication of a right in a new product or the replacement of a product with the same type of product. Where a right or benefit can be valued and an individual suffers material financial detriment, the appropriate remedy is compensation. Consumers should have the right to seek compensation.

While the ABA recognises that there are different legal qualities that apply to different industry sectors – life companies (companies law) and managed investment schemes (trust law), the benefits that could be afforded to policyholders being transferred from a costly life insurance product to a more administratively efficient and technologically advanced managed investment scheme are significant. Therefore, we consider that there should not be a replacement restriction, but rather a product provider must demonstrate under the “no disadvantage test” that the policyholder has equivalent benefits and entitlements and/or is adequately and appropriately compensated.

2.4 Proposed product rationalisation mechanism

2.4.1 Managed investment schemes

The ABA believes that the proposed product rationalisation mechanism for managed investment schemes will provide benefits for responsible entities and members in relation to legacy products. We consider that the responsible entity should develop the proposal for the rationalisation and commission an independent expert’s report.

The ABA makes the following comments:

- A responsible entity should only be required to demonstrate that affected members, as a whole, will not be disadvantaged under the proposed rationalisation.
- An independent expert should be required to meet statutory criteria regarding qualifications set out in regulations.

The ABA supports IFSA’s proposed option (“Option D”) for product rationalisations involving managed investment schemes. We consider that ASIC should be notified of a product rationalisation proposal, but should not be required to approve a proposal. Furthermore, we consider that there should be a defined time (14 or 21 days) for ASIC to provide comments. It is essential that the product rationalisation mechanism operates smoothly and that the responsible entity has certainty as to the rationalisation process.

2.4.2 Life insurance products

The ABA believes that in addition to the APRA approval process for simple product rationalisations and the court approval process for more complex product rationalisation proposals, there should be an additional third process similar to the member objection options proposed for managed investment schemes – “policyholder objection” model.

The ABA believes that life companies should clearly communicate with policyholders and provide notification and details about the proposed product rationalisation. Information should be sufficient enough to enable a policyholder to understand the proposal and how it may affect them. The notification should clearly state that the proposed rationalisation satisfies the legal criteria and clearly indicate that the policyholder may obtain a copy of the full rationalisation proposal upon request. Communications should be made in a manner as agreed with the policyholder. Product rationalisation information should be either provided in hardcopy via mail or made available to policyholders electronically via, say, email.

The ABA believes that product rationalisation documentation should be sent to the regulator prior to issue to policyholders and/or the Court for review and comment only by the regulator. We consider that there should be a defined time (14 or 21 days) for review and comments. Furthermore, we consider that once the assessment has been made by the life company consistent with the legislated requirements (and their obligations at common law), and APRA has been provided with an opportunity to review and comment on the proposed product rationalisation documentation, the proposal could then be communicated to policyholders.

The ABA believes that a life company should be able to withdraw the proposed rationalisation at any time.

The ABA believes that a court approval process is useful for more complex product rationalisation proposals and where policyholders under a policyholder objection model object to, or do not approve, a product rationalisation.

3. Concluding remarks

The ABA believes that in developing the proposal for product rationalisation that it is important to balance the interests of consumers and product providers. However, product rationalisation must be facilitated via a mechanism that provides certainty in a manner that does not involve onerous regulatory, administrative, approval and disclosure processes. Legal and administrative complexities and process difficulties would likely lead to prohibitive costs.

The ABA would be happy to discuss any of the issues raised in our submission with you further.

Yours sincerely



Diane Tate