5 March 2010

Product Rationalisation Project
Corporations and Financial Services Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: productrationalisation@treasury.gov.au

Dear Sir/Madam,

BT Financial Group (BTFG) welcomes the opportunity to comment on the Product Rationalisation of Managed Investment Schemes and Life Insurance Products proposals paper.

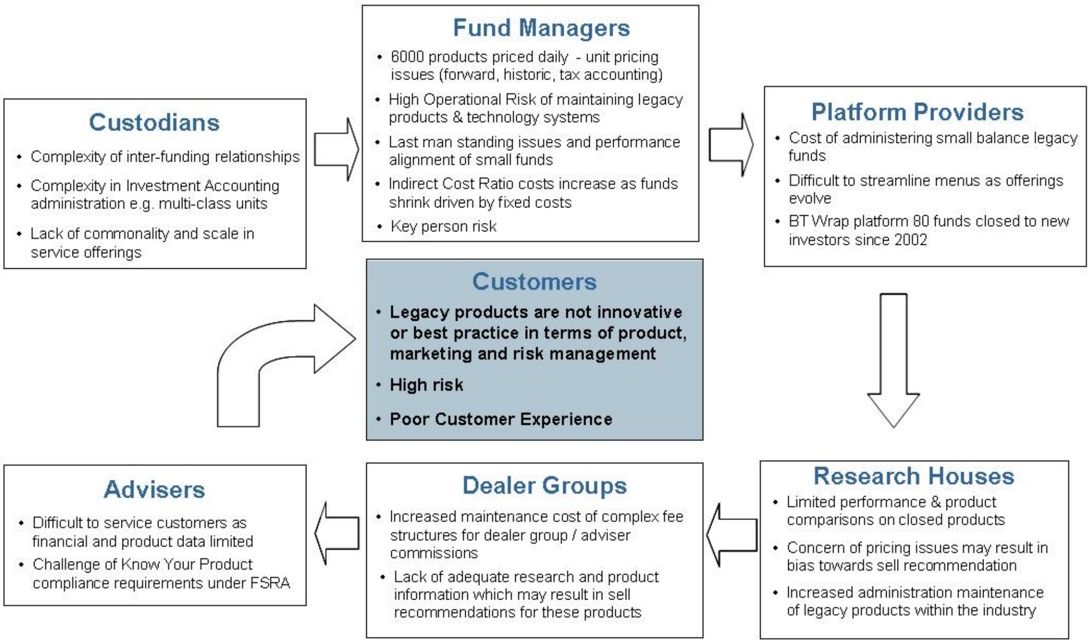
The need to clean up the large number of inefficient, legacy products within the financial services industry has long been acknowledged. We note that discussions between Treasury and industry on this matter have been going on for some time, with several comprehensive submissions and proposals given by IFSA in the period 2005-2007. As a member of IFSA, we actively participated in the development of these proposals and support them in full. We also engaged with Treasury directly in 2005, to highlight the importance of product rationalisation for our business and our customers.

The ability to rationalise our legacy products and achieve better outcomes for our customers, is a priority for our business. However to date the available rationalisation mechanisms across all product types have been unworkable.

Once again we have worked closely with IFSA in the development of their submission on the current proposals paper. Whilst we support the IFSA submission, we would like to highlight and comment on the specific areas critical to our business.

Customers are the ultimate beneficiaries of product rationalisation

In a presentation to Treasury in 2005, the following diagram was used to illustrate the risks and impacts to all financial stakeholders with maintaining and servicing legacy products.



These embedded inefficiencies and risks cause complexity and confusion amongst customers Product rationalisation is necessary to restructure the financial industry and improve customer experience.

We believe that whilst legacy products create a burden on all stakeholders within the financial industry, it is important to remember that customers bear the brunt of this burden. As such, developing an efficient and practical product rationalisation mechanism to move customers into more innovative and competitive product offerings with no financial detriment will ultimately benefit customers. And in the case of superannuation, achieve better retirement outcomes.

We support a phased approach to enable us to move forward

The managed investment scheme (MIS) and life insurance product rationalisation proposals paper acknowledges that pursuing a single approach would be complex and time-consuming, given the broad range legacy products and differing rationalisation circumstances.

Given the urgent need to move forward and enable customers to benefit sooner, we support the IFSA's proposal for a 2 staged approach in developing a workable product rationalisation mechanism.

However we believe it is imperative that the Government recognise that superannuation must be addressed promptly given the impact the impact less efficient, or inefficient legacy products can have on the adequacy of an individual's retirement savings.

Recommendation: We support a phased implementation, but recommend the existing barriers to rationalising superannuation funds be addressed promptly.

Problems do exist with the current superannuation successor fund transfer (SFT) regime, which we outlined in our submission to Phase 2 of the Super System Review, together with a case study from our own experience in trying to consolidate funds. We have attached this section of our submission, together with our case study in Appendix A. We would we welcome the opportunity to discuss this further.

The legacy product definition needs to be extended

The legacy product tests in the proposals paper covers products which become outdated due to regulatory change, inefficient in terms of operating losses or excessive cost increases, or would result in the decommissioning of an underlying administration system if rationalised.

However many legacy products (including many of our own) can continue to cost effectively provide benefits to customers and profits to providers, with their closure not necessarily resulting in the decommissioning of an administration system. Instead these products become outdated and less efficient relative to newer products. Technology and product development innovations can enable modern product equivalents to provide customers with additional features and benefits for the same or even a lower cost.

For this reason we recommend the inclusion of a legacy product test which recognises that rationalising the product into a more modern equivalent, can be materially advantageous to customers.

Recommendation: Introduce IFSA's proposed legacy product test where the rationalisation would be Materially Advantageous to customers.

Legacy products can also be created by industry convergence. BTFG is a prime example of industry convergence, firstly with the merger of 3 wealth businesses into one in 2002 (Westpac, Sagitta and BT), and the subsequent integration with the St George wealth businesses in 2008.

As part of these mergers, inefficient and outdated products were closed to new investors, however none were rationalised into their more efficient product equivalents due to difficulties with product rationalisation mechanisms.

Just as customers should be able to benefit from product rationalisation of a legacy product into a more modern equivalent if it is materially advantageous, they should also benefit if a better product becomes available as the result of a company merger. However customers should not need to wait until the fund is closed for a number of years before the rationalisation occurs.

Recommendation: Consider enabling the Materially Advantageous test to be applied even if the product has not been closed for a period.

Tax neutrality is essential to enable a workable rationalisation mechanism

Current taxation laws present a significant barrier to product rationalisation taking place. The 2008 Ernst and Young Product Rationalisation Survey stated that 85% of respondents cited taxation as an "important" or "very important" barrier to rationalisation.

As outlined in the IFSA submission, immediate taxation relief is the critical element to an efficient and workable product rationalisation mechanism. Members are generally disadvantaged by the taxation consequences arising from the closure of a fund and the transfer to another fund, or even the closure of a product and transfer to another product within the same fund structure. The disadvantage to members effectively impedes consolidation.

Changes need to be made to remove the tax consequences of product consolidation, and make the transfer of a customer's interest and underlying assets tax neutral.

Recommendation: Tax relief is provided to ensure product rationalisation is tax neutral.

The member objection option for MIS should be expanded to life insurance

Furthermore, we would specifically like to state that we support IFSA's proposal for an additional product rationalisation process for life insurance products that is modelled on the MIS member objection options. We believe that this recommendation proposed by IFSA would substantially improve our ability to rationalise life insurance products for the benefit of policyholders.

Recommendation: We support IFSA's recommendation to expand the member objection model to life insurance products

Given the importance of product rationalisation to our business, and the desire to create better outcomes for our customers, we would welcome the opportunity to discuss this submission, and our product rationalisation experience in more detail.

Should you have any questions, or wish to discuss this submission further, please do not hesitate to contact me on 02 8253 1702.

Yours sincerely

Alyson Clarke

Alyson Clarke
Head of Regulatory Affairs

Appendix A – Superannuation Product Rationalisation

Extract from our submission to Phase 2 of the Super System Review

An area of inefficiency in the superannuation system that is difficult to measure, but no less significant is the large number of 'legacy' superannuation funds that exist.

In 2006, it was estimated that a third of the approximately 6,000 financial products in the funds management, superannuation and life insurance industries are closed to new investment.[1] BTFG currently has 20 out of its 52 superannuation products closed to new investors, totalling $1.8 billion in FUA (or 5% of our total superannuation FUA).

The issue of legacy funds, or more broadly funds that are stagnating, is that they often contain outdated product and service features, outdated charging structures, and utilise complex and costly processes on legacy systems. Legacy funds also cause significant distraction, duplication of effort and prevent scale from being achieved.

Legacy funds often sit on registry systems that may otherwise be decommissioned (and that often need substantial ongoing investment and updating), require individual portfolio management attention (even if they are similar to much larger funds that sit within the organisation), and need a range of services - such as audit, unit pricing, disclosure, compliance, legal, annual report production and website maintenance. There are also other costs such as training and maintenance of knowledge of the peculiarities of each fund.

If funds could be consolidated fund sizes would increase, and the fixed costs would be proportionally lower allowing for benefits of scale across the industry which would ultimately result in better outcomes for members.

IFSA has estimated that the annual economic benefits to customers in rationalised products (both super and non-super) could be between $120 million to $350 million. For a customer in a legacy product, these savings equate to around $70 per year.[2]

However even though the desire to consolidate these funds is widespread, significant barriers to consolidation remain and are outlined below.

Recommendation: Introduce legislation, tax changes and incentives which would facilitate fund consolidation

SIS equivalency rights and benefits test should be principles based

The complexity of individual financial products and the range of different features and characteristics make the current "equivalent rights and benefits test" for successor fund transfers impractical. The test is far too onerous, and does not have regard to the overall benefits that will accrue to customers from a product rationalisation. The result is either increase costs in keeping outdated product rules to ensure the test is met, or worse, stopping successor fund transactions altogether.

We support IFSA's submission to Treasury on Product Rationalisation (September 2007) which recommended that the legislation should be principles based, and a single test based on an evaluation that the proposed product rationalisation will result in at least equivalent benefits to the class of customers as a whole, should be required.

We recommend that a Regulatory Guidance be prepared, in consultation with industry bodies, on the application of the principles underpinning product rationalisation. Primary regulators would be

[1] IFSA Regulatory Impact Statement to Treasury on Product Rationalisation 19 May 2006.
[2] Source: IFSA Regulatory Impact Statement on product rationalisation May 2006.

ASIC and APRA, and to the extent that taxation issues are involved, the Australian Taxation Office.

Tax relief for funds that are consolidated

Current taxation laws present a significant barrier to product rationalisation taking place. The 2008 Ernst and Young Product Rationalisation Survey stated that 85% of respondents cited taxation as an “important” or “very important” barrier to rationalisation.

Members are generally disadvantaged from the taxation consequences arising from the closure of a fund and the transfer to another fund, or even the closure of a product and transfer to another product within the same fund structure. The disadvantage to members effectively impedes consolidation.

Changes need to be made to remove the tax consequences of product consolidation, and make the transfer of a customer’s interest and underlying assets tax neutral. As such we support IFSA’s submission to Treasury on Product Rationalisation in September 2007.

While the formal mechanics of rationalisation will vary according to product type, the following four fundamental attributes are necessary:

- The change of the investor’s interest under product rationalisation should be tax neutral for the customer
- The transfer of any underlying assets under product rationalisation must not give rise to an immediate tax liability
- Any tax attributes of the rationalised product need to be carried over to the new product (examples of this are the 45 day holding period for imputation credits and the ten year rule for Life insurance Bonds).
- State Stamp Duty Laws need to be amended so that rationalisation does not trigger exposure to stamp duty. Such relief was provided previously for transitions to implement the Managed Investments Scheme regime.

We acknowledge and the Government’s move to ease the taxation issues for superannuation mergers through the optional CGT rollover for capital losses, which was extended until 30 June 2011. We recommend the indefinite extension of this optional CGT rollover, in addition to addressing the other taxation issues outlined above.

Tax incentives for implementation costs

The implementation costs, made up largely of technology, are no doubt the biggest barrier to product consolidation. The 2008 Ernst and Young Product Rationalisation Survey stated 89% of respondents said that implementation costs are an “important” or “very important” barrier to rationalisation.

We therefore propose that the Federal Government consider introducing specifically targeted tax incentives to encourage industry to rationalise legacy products.

We recommend the targeted tax incentive take the form of a tax deduction of up to 125% of the qualifying expenditure incurred during a 3 year period (commencing, say, 1 July 2010) on superannuation product rationalisation activities.

Governance could be provided by way of a formal registration process for companies that sought to participate in the incentive program supported by a requirement to complete project plans in an approved form that detail the legacy products that are being closed and the related rationalisation plans.

Allowable and non-allowable activities would be specified in regulations. Allowable activities should include expenditure on IT system integration, data migration and related modifications to existing software, and other direct costs (e.g. legal) incurred as a result of product rationalisation.

→ *To demonstrate the current difficulties faced in consolidating superannuation funds, a case study of a real life consolidation example is provided below.*

Case study on consolidation of 3 Approved Deposit Funds

Below is a case study demonstrating the difficulties faced by BTFG in consolidating 3 Approved Deposit Funds (ADFs).

ADFs were established in 1984 as a simple product that would only accept Eligible Termination Payments (ETPs). They encouraged people to preserve their ETPs within superannuation until retirement. They also allowed people to defer lump sum tax. Through the evolution of superannuation and the introduction of more complex and flexible products ADFs lost their popularity and now are closed products (not accepting new business). BTFG had 3 ADFs. As these are closed products BTFG has dwindling funds under management (FUM) and declining revenue but fixed costs.

BTFG decided that to avoid ongoing losses and to improve the options available to the members that these funds would be a candidate for Successor Fund Transfer (SFT). In May 2006 BTFG commenced the process for a SFT at which time the ADFs had 477 members and FUM of $16.1m. In order to carry out a SFT the Superannuation Industry Supervision (SIS) Act has requirements that the Trustee is to consider, including equivalency rights.

To meet this criterion BTFG had to consider:

Tax implications, (capital gains/loss position and Revenue loss position)
Legalities (does the Trust Deed permit SFT)
Equivalency for Customer
Costs associated with system and administration processes involved in converting to the new fund.

Of the above tax implications, legalities and costs were the main barriers to overcome.

Tax implications - One of the ADFs had capital losses valued at $180K. Under current tax law these capital losses could not be transferred to the new fund, and so the equivalency criteria could not be met for one of the ADFs. Due to this impediment, the fund was not able to be consolidated into another fund.

Legalities - Old Trust deeds of the ADFs did not permit SFTs and had to be updated and approved by the Trustee with resultant communication to members. Approximate costs were $130,000.

Costs - The other major barrier to SFTs is the cost of implementation. In order to meet the equivalency requirements, technology infrastructure needs to be built to transfer all member data, including past transactions and tax information, to the new fund. In 2005, these technology build costs were estimated at $1.5m. Given there were 477 members with $16.1m in FUM, these costs outweighed the benefits.

The SFT outlined above took 23 months to execute and was essentially a cost "loss" exercise for BTFG. In addition, the inability to transfer capital losses meant that it was not possible to complete the SFT for one ADF. So the overall objective of consolidating all 3 of our ADFs into another super fund, and to increase the benefits for members - was not achieved. These barriers have meant that BTFG has not considered further internal SFTs.