Thank you for the opportunity to comment on the paper, Review of the provision of pensions in small superannuation funds.

General Observations

1. The new rules are effectively retrospective, in that people who have been planning towards their retirement, but may not have reached age 55 or yet be in a position to retire, now appear to be required to use a product which is not likely to last their lifetime.
2. The paper provides no evidence of the issues the new rules were introduced to address.
3. The suggestion that any document or agreement regarding the commencement of a pension is an amendment to the governing rules is a nonsense.
4. From information available, it appears only a very small percentage of small fund members have balances in excess of the Pension RBL - the people who would be likely to utilise the required factors to produce compression, estate planning, etc. The remaining members appear to have had their retirement income options limited because of a perceived weakness they may never have been in a position to utilise.
5. Origin of the problems is that the prevailing rules have not been regularly reviewed and adjusted.
6. The proposed options seem to be an ad-hoc arrangement to deter a perceived flaw in the current (pre May 2004) system, and appear to actually be contrary to government retirement incomes policy, particularly by removing a level of choice.
7. What is currently available is more likely to result in people needing to rely on social security in years to come, as Market Linked retirement income streams are designed to run out at some point in time. Actuaries indicate that there is a 60% probability that one member of a couple will be living at the time the pension ceases, even after applying the 5 year adjustment.
8. If there are changes to the rules for the provision of defined benefit pensions, as set out in strategy 5.2 of the Treasury Paper, those changes should apply to all funds.
9. Life companies are retreating from providing life annuities because of the longevity risk. In the UK there is a real risk to the payment of pensions by life companies. With a SMSF, in the event of poor investment performance, the pension can be (could have been) commuted and re-commenced at a lower rate.
10. There is no guarantor in the SMSF environment. SMSFs are the only funds where the pensioner accepts the risk that a "life" pension may run out of funds before the pensioner dies.
11. Treasury seem to be overly concerned with Social Security trade offs, when the small number of people the new rules target are not likely to be in a position to access social security.
12. Consideration of the needs of pensioners seems to be missing from the paper.

13. No longer is there a pension available that satisfies the pension and annuity standards and which is assessed against the pension RBL of the pensioner that is available for the life of the pensioner.
14. The only pension that qualifies for assessment against pension RBLs that provided some certainty that it would be paid for the pensioner's lifetime has been the lifetime pension under the SIS Regulations.
15. Similarly the only pensions that provided a degree of certainty of the level of income stream are the so-called "defined pensions" - lifetime and life expectancy. The market-linked pension does not provide the same level of certainty.

Pensioner Needs

Arising from these general observations it is clear that if SMSFs are satisfy the needs of their members, they should be able to offer pensions with the following characteristics:

1. It is account based and commutable only in the manner currently available for market-linked pensioners.
2. It is available for life, but with no guarantee and with pensioners having the longevity risk.
3. It is assessable against the pensioner's pension RBL.
4. It is reviewed annually and its currency is extended based upon the then life expectancy of the pensioner - ie, the pension factors recognise that as a person ages, their life expectancy changes.
5. The amount of the pension is based upon pension factors that take account of life expectancy changes.
6. To eradicate the possibility of significant changes in the rate of the pension from year to year and provide a greater degree of income certainty, account balances be smoothed over a five year period so that the pension factor is applied to the smoothed account balance to give the pension rate.
7. All income received by the SMSF in respect of the amount supporting the pension, including that which is the product of smoothing, be exempt from tax.
8. Pension reversions are limited to spouses, interdependants and financial dependants.
9. Capital remaining after the death of the pensioner or the reversionary pensioner is to be cashed from the superannuation system as ETPs or death benefit ETPs.

In addition to the above, it is considered that pensioners should be able to augment their account balance that is funding a pension by making undeducted contributions at any time after retirement.

Conclusion

There is support for the removal of the concepts of guarantee and defined benefit in relation to SMSFs.

There is also support for the establishment of a lifetime market-linked pension that caters for pensioners that live beyond their life expectancy and which allows a smoothing of income payments to minimise wide fluctuations in pension payments from year to year.

The concepts outlined at 5.3.1 and 5.3.3 of the Treasury paper, if applied to create a pension with the above mentioned characteristics are supported as it is believed that such a pension would deliver the type of income stream choice that pensioners are seeking while addressing the taxation and social security issues perceived by the Government.

A lifetime market-linked pension would regularise what is currently available through on-going commuting and re-establishing market-linked pensions which has the effect of extending the life of the pension each time it is recommenced. The complexities of establishing new pensions on a regular basis and the associated administration would be removed, simplifying the delivery of pensions to members.

Kind regards,

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