17 March 2005

The Manager
Retirement Income and General Rules Unit
Superannuation, Retirement and Savings Division
The Treasury
Langton Crescent
PARKES ACT 2600

e-mail: dbpensionreview@treasury.gov.au.

Dear Manager,

**Re: Review of the provision of pensions in small superannuation funds**

The National Institute of Accountants (NIA) is one of the three professional accounting bodies with almost 14,000 members. The NIA, amongst others was concerned when the Government announced that small funds would not be able to have the option of a Defined Benefit Pension (DBP). While the NIA appreciated the Governments desire to prevent abuse of the DBP for tax purposes, there were a number of reasons why small funds should legitimately be able to have the option of a DBP. The NIA appreciates the Governments decision to hold off on some aspects and to consult with industry and the professional bodies.

The NIA supports many of the provisions set out in the discussion paper, and is of the view that the Government should not be constrained by needing to adopt only one of the proposals for reform in the discussion paper. The NIA believes that each of three major suggested options has their own merits and should be considered as part of a round table discussion with the industry and the professional bodies.

In particular the NIA supports:

- Reforms to address RBL compression issues;
- Updating the economic and mortality tables;
- Modifying the market linked products to allow smoothing and extending the maximum term; and
- Introducing new pension products

The NIA believes that the role of the Government is to set out the rules and ensure that there is no abuse, and that is ten for industry to develop the products within those rules and let the market determine which products are successful. The NIA would welcome the opportunity to participate in further development of the proposals.

Yours Sincerely

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**Review of the provision of pensions in small superannuation funds**

## Introduction

The National Institute of Accountants (NIA) is one of the three professional accounting bodies with almost 14,000 members. When the government announced in 2004 changes that would effectively bar small funds from having Defined Benefit pensions, the NIA, amongst others, was concerned that this would unfairly impact members of small funds. The NIA encouraged the Government to reconsider its proposals and look for new means that allowed for forms of defined benefit that did not lead to abuse.

The NIA believes that there is the need to have a roundtable discussion on all the options that are set out in the discussion paper. The NIA is of the view that it is for Government to set the rules and ensure that abuse is not happening, then it is for industry to develop products in line with those rules and for the market to determine if they are popular or not.

## Options for addressing RBL Compression

The NIA is of the belief that the best means of addressing the Reasonable Benefit Level (RBL) compression issue is for the government to adopt both proposed approaches as set out in the discussion paper. The NIA does not see that these are two unconnected approaches. The pension valuation tables are seriously out of date and therefore do not fully serve the purpose for which they exist.

Regardless of the Defined Pension issue, the pension valuation tables should be updated and broadened to take into account current economic and life-expectancy data. The NIA would support broadening the tables to include new factors that are now available and that are more tailored to specific facts, such as differences between male and female life-expectancy.

Merely updating the pension valuation tables though will not be enough and as the discussion paper notes still allows for some RBL compression through adjustments to the pension’s purchase price. That is why the NIA would support measures that are based on the purchase price of the pension. It is important that “the playing field” is leveled. How this can best be determined though should be the subject of further discussion and adds to the call that a “round table discussion” be called with industry, the professional associations and the Treasury to work through these issues.

## Options for addressing estate planning

The NIA would support the adoption of some measures to address the issue of estate planning that is designed to get around the rules relating to superannuation. Of the measures suggested in the discussion paper, the NIA would support:

- Ensuring pensions provide a reasonable level of retirement income through the use of actuarial guidelines and other measures;
- Restricting the residual amounts paid if a pension is commuted; and
- Limiting reversion so that excessive amounts are not paid out to spouse and/or other dependants;

The NIA would also support measures that would tax at higher levels (eg as “special income”) excessive amounts of pensions reserves.

**Key questions on the strategy to develop new rules for defined benefit pensions**

*Defined benefit pensions in non-arm's length funds can be structured to provide a residual capital value. What role do residual capital pensions and annuities have in providing retirement income?*

The NIA does not have any comment on this issue.

*What would be the likely demand for defined benefit pensions in small funds if the above measures to develop new rules were implemented?*

The NIA would not be able to quantify the actual numbers, however, when the Government first muted the idea of removing defined pensions from small funds, there was a large amount of concern in the industry and by retirees. While a defined benefit may not suit a lot of people, especially given the new market linked products, there is still a section of the community that intends to use Defined Benefit pensions. The NIA does not believe that this number would be large, but nor is it likely to be inconsequential. There is no reason, if the suggested changes are implemented, for defined benefit pensions not to be offered to retirees, as the concerns of Government will be addressed and retirees will have an option that some clearly want to have. Given that there demand exists for this type of product, the NIA believes it should still be available to retirees.

**Modifying existing pension products**

The new market linked products do appear to have been well accepted by the retirement community, and the NIA would support measures that offered some amendment of those products.

*Extending the maximum term of market linked pensions*

One of the concerns that some commentators have made in relation to the market linked products relates to the life expectancy calculations. These are generally seen as not providing the certainty that is expected and are seen as not being long enough. Some have suggested that there be a blanket life expectancy, eg 95 years while others have suggested that there be an uplift factor (eg life expectancy under the tables plus 5 years). The NIA does not believe that a blanket life expectancy would be warranted, but does agree that there needs to be a mechanism for people to choose to set a higher life expectancy than that stipulated in the tables. As the average pension payment will be extended over this period, it is the retiree who will have the lower income (over a longer time). This option should be available, where the life expectancy set out is reasonable. People should not fear what happens if the live longer than statistics suggest.

*Attaching longevity insurance to market linked products*

The NIA would not oppose the possibility that a deferred annuity could be attached to market linked pensions. This may provide the retiree with the comfort they need if they are concerned that they will outlive the market linked pension. The NIA would not see this as being preferential to being able to extend the term of a market linked product, but should be one option that is provided for in the legislation.

*Smoothing of pension payments*

For most retirees they seek to have a stable amount of income each year so that they can more easily budget, this is one of the advantages of the defined benefit pension. Providing market linked products with the ability to smooth out the ups and downs each year, would mean that such products would be more agreeable to those who might otherwise want a defined benefit pension. The NIA would therefore support the ability of market linked products to have a mechanism that would allow payments each year within defined ranges. This would do away with their being a tax planning element but allow for smoothing and greater consistency in pension payments. The NIA would support the ability to smooth out within a band of around plus or minus 10%.

*Updating the basis for allocated pensions*

The fact that allocated pensions can only be paid up to a retirement age of 80 is unacceptable. There have been numerous demands over the years for this to be updated to a more realistic figure. The factors have not been updated since 1992. In that time the data has changed significantly and the number of people living past 80 has increased. It is one of the reasons that some people choose not to have an allocated pension. The updating of the economic and mortality assumptions should happen regardless of other suggestions in the discussion paper. There should be requirements for regular updating of those figures.

**Key questions on the strategy to modify existing products**

*Would there be demand for the above mentioned products?*

While the NIA can not point to any survey to suggest that there would be demand for such products, in discussions with members and others involved in the area, there appears to be support for many of the proposed amendments. As noted above the updating of the economic and mortality assumptions for allocated pensions should happen regardless of the decision on other suggestions in the discussion paper.

The NIA also believes that there should be the ability to smooth out pension payments from market linked products as well as for extending the maximum term of market linked pensions. The NIA does not oppose the ability to attach longevity insurance.

The NIA though does not believe that the choice should be between either modify existing products or changing the existing defined benefit rules. The two can co-exist.

*Would the industry be willing to offer such products?*

The NIA is not a provider of such products and can not say with any assurance what the actions of industry would be. The NIA though believes that there is likely to be demand for such products and if that demand was significant enough then it is likely that at least some in the industry would offer such products.

**Introduce new pension products**

The NIA would welcome the discussion of the possibility for new products to be offered to the market and is pleased to see that the industry is prepared to develop products that meet a specific market niche. Such products though would need to be developed in such a way that they could not be used for tax planning purposes. The NIA believes that it is up to industry to develop the products and the Government to set the rules. The NIA does not believe there is a need, at the current time, for the Government to be involved in offering products, merely because industry has not taken up an option. As long as there is strong competition within the industry, as there appears to be in Australia, then the Government role should be that of setting the rules.

*Lifetime annuity with annual rebalancing within a corridor*

The NIA believes that a product of this type should be available for industry to offer. It allows for smoothing of income within bands and the ability to review so that it is not abused. The ability to extend the period out to a later age is also welcome. The NIA would support the re-balancing method. The NIA would again though note, that as long as the product does not lead to abuse and tax avoidance, it should be made available. It is then for the market to decide whether such products are popular.

*Annuity certain with annual rebalancing within a corridor*

The NIA would repeat what is said above. The NIA does not see any reason why such a product should not be made available as a choice. It has benefits and what may be to some negatives. It is up to the market to determine what products are provided (within the rules) and for the pension purchasers to determine if a product is popular. It is hard to say without data which of the proposed products would be more popular, however, if industry believes they would viable, then they should be afforded the opportunity to provide such products.

**Key questions on the strategy to introduce new products**

*Should new products be introduced or should modifications be made to existing account based products?*

The NIA would repeat what it has said earlier, the NIA does not believe that there needs to be a choice between the options suggested. They all provide options that would likely be welcome in the market. Rather than have the Government determine which should be applied, the NIA believes that all three sets of options (new products, changes to Defined benefit rules and changes to existing products) should be allowed. It would then be up to the market to determine which of the various options are popular.

*Would the industry be willing to offer such products?*

The NIA can not say whether industry would but since the options were suggested by those in the industry, this seems to indicate there is at least some industry support. Let industry and the market decide.

**Conclusion**

The NIA believes that the discussion paper contains some very useful improvements to the retirement incomes sector and that it should form the basis of “round table discussions” on how best to progress the proposals. The NIA also does not believe the choice is between one or another of the options but that there is room to consider all of them.