Submission

Review of the Provision of Pensions in Small Superannuation Funds

Background

As a practicing Financial Planner, I will try and give you a feel as to how the industry and members of the public look at some of these issues.

To date, two of my clients have decided to run Complying Lifetime Pensions through their self managed superannuation funds.

For each of these clients it was a difficult decision, as I, and others explained fully the messiness and "hassles" they would endure.

Essentially many of my clients are stuck between a rock and a hard place. Once you are over your Lump Sum Reasonable Benefit Limit (LSRBL), your alternatives become difficult.

I would describe my client's objectives as the following:

- Having a strategy they understand
- Having a strategy that allows flexibility
- Having a strategy that is within the law
- Having a strategy that delivers the after tax income they require
- Having a strategy that is easy to administer
- For their estate not to pay a massive amount of tax upon their demise

The Government Needs to Decide What It's Objectives Are

The general public currently find it exceptionally difficult to understand the superannuation regulatory environment.

The government (as I understand it) has an objective of people becoming self funded retirees. To encourage this, it gives tax encouragement (concessions) for people to save for their retirement using superannuation. In 1994, the government introduced RBL's, a Lump Sum and a Pension RBL. These were $400,000 and $800,000 respectively. These RBL's were (we understand) put into place to stop people abusing these tax concession.

The government (as I understand it) has an objective of making superannuation easier for people to understand.

The government has an objective of generating taxation revenue.

Over the last 10 or so years, the regulations on superannuation have become massively complex with many advisors spending many hours per year keeping up. This complexity and constant change has the effect of reducing the public's confidence and consequently makes them less inclined to use superannuation.

In addition, most middle mangers will be over or close to their LSRBL by the time they retire.

The government needs to recognise these objectives and not totally consistent, and explain what it's objectives are, (and the priority of its objectives), and to then take steps to achieve these objectives.

How to Reduce the Problems

My main contention is that the current methodology for increasing the RBL's each year is poorly thought out and inappropriate. Currently, the RBL limits are increased each year on 1 July by AWOTE (Wage Inflation – generally inflation plus 1 – 2 %).

Superannuation funds could well return inflation plus 5 – 6 %, thus many people will be in excess of their LSRBL due to their compulsory superannuation.

The indexation of RBL's should be at inflation plus 6/7/8 %

If the $400,000 LSRBL limit of 1994 had been indexed at the rate of return of the stock market, the limit would be closer to $800,000 for the LSRBL not $619,000

Comments on Concerns with the provision of defined benefit pensions

- RBL Compression – Schedule 1B from the SIS regs has been used to compress RBL's
- Social Security Benefits – it is possible for a couple of pension age to place considerable funds (say $300,000) into a lifetime pension and purchase an income for life and then get close to full Age pension – thus living on $30,000 plus combined after tax indexed

for life. Upon their demise, their estate would include their residence – A couple with $600,000 in investment assets may have the similar after tax income without any Centerlink Pension

- Estate Planning – the general public get really annoyed when their super (or part thereof) upon their demise is likely to be taxed at 48.5% - this tax on their excessive benefit is one of the main reasons why the public reluctantly choose to run a complying pension through a SMSF
- Pooling of Risk for a small number of members – from the members perspective, they are not concerned with outliving the funds in the SMSF – they wish to have control – they do not want to see their super taxed at 48.5% upon their demise.

Options

If you change and adjust the way RBL's are indexed, you make life a lot simpler for the general public and reduce the need for unproductive strategies.

Term Allocated Pensions are a step in the right direction.

The changes to the Asset Test for Centrelink will reduce the number of people (and / or reduce the size) able to receive the Age Pension.

Management of investment, liquidity and mortality risks – the first two you can control, the latter unfortunately not.

Likely demand for effective Excess Benefit RBL Strategies is going to increase as you currently have an exploding equation, mandatory contributions and earnings usually well above the level of indexation for the RBL limit will lead to many many people having RBL problems.