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General Manager
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The Treasury
Langton Crescent
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Dear Trevor

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

CPA Australia welcomes the opportunity to make an initial submission to Treasury's review of the provision of pensions in small superannuation funds.

The following points are provided as comment and to identify issues for Treasury's consideration in the development of the proposed discussion paper. More detailed commentary and information can be provided in subsequent submissions and through consultation once the discussion paper has been released.

**The use of pensions in small funds**

The prohibition on small funds commencing defined benefit pensions has created an uneven playing field whereby the members of small funds, and in particular self managed superannuation funds (SMSFs), do not have the same range of retirement options available to them as do members of superannuation funds. As we highlighted in our correspondence to the Assistant Treasury on 7 June 2004 and in our submission to the recent Senate Economics committee enquiry, there are many practical and cost factors which effectively restrict many members from accessing an income stream outside their SMSF.

The choice of income stream in retirement is influenced by a number of factors. One of the main factors is the need to maximise retirement income, and this is achieved by qualifying for the higher pension reasonable pension limit and/or the age pension. In the past this has been achieved in an SMSF by commencing a complying lifetime or life expectancy pension.

CPA Australia believes that in the majority of cases, the new market linked income streams (MLISs) will provide a viable alternative to the traditional complying pensions and satisfy the needs of most retirees wishing to access the pension RBL and/or satisfy the assets test exemption for the aged pension.

However, income streams are not only used for these concessionary reasons and are often used simply to receive a regular income in retirement. By using a defined benefit pension a level of certainty can be achieved, with knowing how much they will receive and how long it will last, that is not possible with an allocated pension. The ability to put some aside for estate planning purposes is not unreasonable and is within the spirit and the letter of the superannuation legislation.

The ability to provide fixed term income streams is still available commercially but not within an SMSF. Again, an uneven playing field. Fixed term pensions with an SMSF should not create the same concerns that surround lifetime or life expectancy pensions. They do not qualify for the pension RBL and there are no estate planning issues. If there is any residual, it will be caught within the RBLs and treated accordingly. Investment risk should not be anymore of an issue than it is for allocated pensions or MLISs. In each case, it is the member who is bearing the risk.

An alternative to fixed term pensions within SMSFs would be to allow fixed term MLISs with or without a residual capital value. These would not qualify for the pension RBL or assets test exemption but would provide a valuable alternative to retirees with SMSFs.

Defined benefit pensions were also used to provide a level of comfort and certainty to more risk adverse retirees because of the nature of the 'guaranteed' regular smooth income stream. While it can be argued that this can still be achieved using low risk type investments within an MLIS, it is an issue that should be explored as part of Treasury's review.

**RBL compression**

The prohibition on small funds commencing defined benefit pensions does nothing to address the problems associated with RBL compression. RBL compression is still available to members of SMSFs able to commence a lifetime pension under the grandfathering provisions, as well as members of defined benefit corporate and public sector superannuation funds. If RBL compression is a concern, then these people have an unfair advantage over individuals who must purchase an income stream.

RBL compression should be addressed in two ways. Firstly, where a value can be placed on the assets underlying the pension at commencement, it should be used for determining the RBL. This would address the SMSF issue.

Secondly, the pension valuation factors used in the calculation are now ten years out of date and out of line with current life expectancies. Updating these factors would provide an RBL that is more representative of the benefit available and remove the unfair advantage that individuals using the 'annual value' calculation have over those who must use the 'purchase price' calculation.

**Estate planning**

Current Government policy, as reflected in the proposed contribution splitting legislation, will allow individuals to split their superannuation with their partner to access two RBLs.

However, the concerns raised that unnecessarily high levels of reserving for defined benefit pensions within SMSFs are being used for excessive estate planning seem contrary to this policy.

Any reserves in excess of what is needed to support a pension should be taxable within the fund. If any forfeited reserve is distributed between the other fund members, it will count towards their RBLs and be treated accordingly and be appropriately taxed when a benefit is paid. Given any reserves should not fall outside of the superannuation tax regime this practice should be viewed as being consistent with the policy objective of allowing an individual to contribute to their partner's RBL.

Further, the measures introduced on 11 May do not address the reserving used by funds that are already providing defined benefit pensions. If excessive reserving is a concern, consideration should be given to reviewing the actuarial standards to ensure reserves are not created that are surplus to the needs of guaranteeing a defined benefit pension.

**Investment risk**

Investment risk should not be a consideration when deciding the appropriateness of SMSFs providing defined benefit pensions. The investment risk associated with a defined benefit pension within an SMSF is exactly the same as for a MLIS or an allocated pension. Due to poor investment performance or decisions, the money may run out early. If anything the risk is less as the funding for a defined benefit is regular overseen by an qualified actuary. If individuals are willing to take this risk with their own money, they should be allowed to.

CPA Australia looks forward to participating further in the review process. Should you have any queries or require further information, please contact me on (02) 6267 8585.

Yours sincerely

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