smartsuper
superfund administrators

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

Dear Sir

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

Thank you for the opportunity to make a submission in relation to the above review.

Smartsuper, as a professional administrator provides administration to a range of funds from large to small funds and in its operations administers funds with all current types of pensions, accumulation and lump sum benefits for Small APRA Funds (SAF) and Self Managed Superannuation Funds (SMSF). (For the purpose of this report I have grouped these 2 types together as DIY funds)

Our clients with our service use an independent deed provider (Freehills) and independent Actuary (Price Waterhouse Coopers) and an independent Auditor (Ure Lynam). These professional groups are brought together as part of our service offering.

We are concerned to ensure that funds are administered in accordance with the legislation and to that end in accordance with the spirit of the legislation.

We are concerned that the recent changes made by the Superannuation Industry (Supervision) Amendment Regulations 2004 (No. 2) in applying an outright ban to small funds providing life-time and fixed term pensions (with fixed payments) were poorly targeted approach to dealing with the concerns which the government was seeking to address, which has resulted in some significant reductions in facilities used by funds to provide defined benefit pensions.

We are of the view that a more targeted approach which resolves the governments concerns whilst maintaining the flexibility of pension structures can be achieved through the introduction of a range of more specifically targeted actions.

Why are DIY funds growing at the rate they are?

The government has specifically encouraged people to take responsibility for their own retirement. The government has in the past introduced and continues to introduce financial and taxation incentives for people to utilise superannuation as a means of providing for their retirement. Further to this has been the introduction of both allocated pensions and more recently the introduction of Term Allocated Pensions (TAP) to provide forms of retirement income streams rather than encourage people to take lump sums, until now.

As a result of the drive for people to be involved in the planning of their own retirement we have seen an increase in the size of retirement savings generally. In the discussions we have had with our clients the clear message is that our clients established DIY funds is the desire to take control of their superannuation assets and have an active role in how it is invested and how and when it is paid to them. This is a specific move away from having an institution do this for them. There is a fundamental concern about fees, commissions and services provided by large institutions who

smartsuper pty limited
abn 47 003 822 339 afs licence 247120
11 ridge street, north sydney nsw 2060
PO box 529, north sydney nsw 2059
phone: 1300 138 348 fax: 1300 138 349
www.smartsuper.com.au

purport to provide all the answers for what is generally the second largest asset an individual has outside of their own home. The larger this asset becomes the more people will want a say in what happens to it.

To reduce the options or to force people back to institutional solutions may actually have the opposite effect of reducing the savings into superannuation.

It would seem that an action which denies a very large group of the retirement sector access to the ability to pay defined benefit pensions is inconsistent with the policy of the government.

What is left, Allocated pensions and TAP's?

The only commutable pension directly allowed by a DIY since the introduction of these changes is an allocated pension.

There are a number of fundamental issues with an allocated pension.

1. The early years drawing from an allocated pension (as a minimum) is significantly higher than a TAP or a lifetime pension, therefore reducing the capital is reduced from the fund providing less certainty for the latter years.

2. There is no ability to reduce payments to ensure that the spouse is looked after over their life.

3. The pension does not give access to the higher RBL

4. Fully asset tested, and as a result is not as useful where the individual may receive Centrelink support if using a TAP (yet the TAP is marketed linked and pays an amount by dividing the fund value by a factor in a similar way to an allocated pension)

TAP's are non commutable therefore limit access to lump sums if needed. If used to provide the income to the spouse then the loss of flexibility is significant because of the non commutability. It is likely that these pensions will only be used for the higher balances where client wish to avail themselves of the higher RBL, noting that the 50/50 rule still applies to this pension to use the higher RBL.

For smaller clients who wish to gain Centrelink benefits, the amount paid varies from year to year and as such there is no consistency of the payment and no ability to plan as the Centrelink payments may well also change from year to year. This introduces significant concerns to the elderly.

The question is do these 2 pensions really provide for the needs of individuals and the answer is "only for some".

For the significant number where allocated pensions and TAPs do not meet the needs they are forced to use an institution or take the money as a lump sum.

If the DIY fund uses an institution, then it should be noted that one of the governments concerns about compression of RBL is not changed which is a concern.

If, as a concern, this is a practice to be targeted, then the mere moving of the facility from the DIY fund to an institution does not alter the end outcome, it simply reduces flexibility of investment and increases fees, charges and commissions.

A key concern for people is that the assets which they have worked for and saved over their life, on their death (recognising that not all people outlive their life expectancy) should pass to their beneficiaries not to the reserve account of the institution or to the shareholders of the institution through increased profits from fees on money it did not pay back to the person who invested it with them or their beneficiaries.

This itself is a very significant deterrent to individuals to use institutional funds. The more likely result is that lump sums are taken.

Addressing the government concerns

The concerns of the government are set out in the terms of reference for this review.

We believe that these concerns can be addressed by making changes to the existing rules without the need for the banning of defined benefit pensions from small funds

Access to unintended tax benefits, particularly from the use of "RBL compression"

The resulting effect of compression comes from the use of the governments capital value formula. The effective result of the use of this formula can either be a compression or an over statement of the RBL as a result of the use of the components.

Issue The factors applied in Schedule 1B are not reflective of the issues of todays investments, CPI rate and rates of return.

Resolution This schedule should be reviewed to make the figures more in line with the events of the day.

Issue Undeducted contributions are recognised in the formula which can give rise to dramatic RBL compression.

Resolution Remove undeducted amount from the calculation leaving only the taxed element to be used for the calculation of reportable RBL

Overstatement of RBL's

Little has been said about this as an issue for individuals.

Example of how this effects the calculation

- Commence a term pension for 15 years with a 50% residual capital value. In this case the pension is a SIS reg 1.06 (6) pension ie commuteable.

Example Fund - Term RCV pension calculator for Mr Example

Fund Name	**Example Fund**	
Member Name	**Mr Example**	
Date of Birth	**03-September-1939**	
Pension Start Date	**01-October-2004**	
Amount invested in Pension	**400,000**	
Undeducted Amount	**-**	
Residual Capital Value	**200,000**	
Age	65	
Term	15	
Expense Rate	2.00	%
Investment Reserve Factor	9.0%	
Growth Rate percentage - Return Used	6.0%	
Pension Valuation Factor	12.04	
Gross Pension	**25,667**	
RBL Value		
Pension Payable	25,667	
ATO Factor	12.12	
Undeducted Amount	-	
Residual Capital Value	200,000	
Capital Value for RBL	**511,090**	

Sex
Male (selected)
Female

% of Growth Assets
0-19%
20-39%
40-59%
60-79% (selected)
80-100%

Indexation
No Indexation
CPI Indexation (selected)

In this situation, at age 80 the fund will have a balance of $200,000 which is similar to the position of an allocated pension, yet has reported an RBL value of $511,090 in stead of $400,000. Even if this was done all with undeducted money it would report an RBL of $111,090 rather than Nil.

Individuals use these pensions for stability of income payments. In this case the individual knows what the payment is each year, it is indexed with inflation and knows what the amount is at the end of the term. The pension creates comfort and certainty.

If the RBL reportable was the taxed element of this pension it would be the same amount under a TAP or allocated pension yet would provide the comfort and certainty of this pension type whilst still being commutable if something unforseen was to occur whereby the individual needed a lump sum.

Access to unintended social security benefits

If the capital value formula is amended or altered to reflect the true position of the RBL position then this becomes les of an issue.

A DIY fund is less favourably treated now than an institutional fund. DIY funds generally give rise to an amount of deprivation which Centrelink has imposed to counter the effect of the difference between the pension paid and the amount invested.

It must therefore be noted that the simple act of banning the small fund from using the pension does not really effect the ability for an individual to take advantage of the extra Centrelink payments as individuals who engage in this practice would simply take a institutional investment and utilise the same resulting calculation (without deprivation giving rise to a higher Centrelink payment) and claim Centrelink benefits.

A resolution to the calculation is important in this case not the removal from small funds offering the pensions.

Estate Planning

It is recognised that the sole purpose test states a core purpose as follows Section 62

(v) the provision of benefits in respect of each member of the fund on or after the member's death, if:

- (A) the death occurred before the member attained the age prescribed for the purposes of subparagraph (ii); and
- (B) the benefits are provided to the member's legal personal representative, to any or all of the member's dependants, or to both; or …..

Whilst it is recognised that the Act sets out a core purpose to provide for the passing of assets to the estate or to an beneficiary of the deceased, there has been noted a concern over the use of reserves as an active means of estate planning.

There seem to be 2 issues here:

1. The potential size of the reserves and
2. The use of reserves to meet the longevity risk of a pension

If the reserves are limited to the "best estimate" reserves then the lifetime longevity risk could become an issue. It should be noted that this possess little income risk to the government as the pension only receives tax exemption for the pension assets based on the best estimate position NOT the lifetime position.

If the concern is that the lifetime reserves are too great, then perhaps a table of reserve factors can be introduced which provides a comfort factor for the government.

Given that the amount in reserve, when reallocated as a result of death becomes a RBL reportable asset of the member to whom it is allocated it is effectively being counted for RBL's twice along with the lack of tax reduction already provides a substantial benefit to the government. Having less in reserve should not be an issue either, given that the government has introduced a TAP which has no reserve. If the member invests it in a manner which results in a reduction of capital then the

TAP simply pays less out and the member has to deal with that, so why would it be any different if the reserves where fully allocated and the member still had to commute and pay less out? We should remember in either case the member end up in the same position. This also resolves the issue of “pooling”. It should not be that one person is supported by another from any fund. If the individual invests in such a way that the capital reduces because of the investment then the Act provides for the pensions currently to be commuted an recommenced at a level that the asset will support.

Alternatives in summary

Change to the Capital Value formula, by either:

- Replacing it altogether with the same process that is used for Allocated pensions and TAPs
- Updating the Schedule 1B factors to reflect the current days position
- Changing the calculation to remove undeducted amounts

Introduce a commutable version of the TAP

- Allow people to make sure their spouse is looked after, after their death.
- Giving back some of the flexibility lost

Maintaining Term Certain Pensions using best estimate factors rather than lifetime factors

- Allows for consistency of payments
- Comfort of income streams
- Known end results of the pension

Maintain Lifetime pensions requiring best estimate factors to be used recognising the RBL value as the capital invested (less the undeducted amount)

General

This is an opportunity to improve the superannuation platform for all and to remove the perceived areas of rort whilst delivering a sensible, practical and flexible solution to superannuation. Unfortunately superannuation is becoming seen as something forced upon us and less of something that makes people desire to use it. Perhaps this is an opportunity to deliver an effective result for all.

Thank you for allowing me to submit this paper and I am happy to make myself available to work with the government on this matter to finding an effective result for all.

Yours sincerely
Smartsuper Pty Limited

Andrew Bloore
Managing Director