



Institute of Actuaries of Australia

**Submission of the Institute of Actuaries of Australia  
(Institute)**

**Review of the Provision of Pensions in  
Small Superannuation Funds**

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## **Submission of the Institute of Actuaries of Australia (Institute)**

### **Review of the Provision of Pensions in Small Superannuation Funds**

#### **1. 12 May changes relating to defined benefit pensions from small funds**

The recent changes made by the Superannuation Industry (Supervision) Amendment Regulations 2004 (No. 2) in applying a blanket ban to small funds providing life-time and fixed term pensions (with fixed payments) was a very broadbrush and, in our view, poorly targeted approach to dealing with the concerns which the Government was seeking to address with respect to these arrangements. The Institute is of the view that more specifically targeted measures could effectively deal with the issues raised by the Government.

##### **1.1 Consistency of ban with general Government policy?**

Government policy has, over a number of years sought to promote people to save for their own retirement and take more control over their own retirement funding. This has been encouraged via a combination of financial incentives to save more, concessional taxation treatment, increasing the flexibility within the superannuation system, introduction of an additional retirement pension option (the new Term Allocated Pensions or TAPs), the recent introduction of choice of superannuation fund legislation as well as generally trying to encourage people to draw down on their superannuation in retirement as an income, rather than a lump sum.

From our perspective, the recent move to deny a large and growing sector of the retirement market the ability to provide life-time and fixed term pensions from their own self managed superannuation funds seems inconsistent with this policy. We believe that the Government should be making it as attractive as possible for people to take their superannuation savings in the form of an income stream in retirement, preferably spread over their lifetime, rather than reducing their choices and options.

##### **1.2 Allocated and Term Allocated Pensions (TAPs) do not meet everyone's needs**

While allocated pensions are a very popular retirement product due to the flexibility they provide, they are not likely to meet everyone's needs:

- Allocated pensions do not provide access to the higher pension RBL or asset-test exemption for Centrelink purposes. Consequently, they may not be attractive to people with smaller account balances who may gain some benefit from a partial asset-test exemption, or those with larger account balances who are seeking to access the higher pension RBL;

- In many cases, a pensioner is unable to maintain the same real pension level for the rest of their life with an allocated pension, as the minimum drawing rate forces out the income too quickly in the early years, thereby reducing the capital available to support the pensioner in the later years. (To illustrate, refer to the Government cameos presented to the recent Senate Economics Legislation Committee hearings, which show that the allocated pension drawing at commencement is much higher than both the TAP and the life-time pension).

The new TAPs will be suitable for some retirees, but again, are not likely to meet the needs of all.

- TAPs may not be suitable for retirees who wish to live off their retirement savings for the rest of their life. A TAP will cease after a set number of years, with retirees potentially falling back onto the social security system after that time, which could result in a significant reduction in income and adjustment in living standards at a late stage of life. Since the TAP factors are based on census mortality, 50% of those who base the TAP on their life expectancy at retirement will fall into this category. A reasonable number of those who base the TAP on the longer allowed term will also outlive the pension stream.
- TAPs may not be suitable for retirees who seek a stable level of income during retirement, since the income level will move up and down each year depending on the remaining account balance (there is no flexibility in the Government's prescribed pension drawing factors).
- The shape of the TAP income stream may not accord with a retiree's lifestyle needs. Some retirees may require higher real incomes in the early years of retirement when they are more active, and less in later years as they move to an increasingly sedentary lifestyle. Other retirees may desire a higher income later in life as medical expenses consume a greater proportion of income. The TAP factors provide the same shape income stream for all - an increasing income stream over time ending with a sharp "cliff".

In our view, in order to encourage retirees to draw their superannuation in the form of an income stream in retirement, it is preferable that they be provided with sufficient choices to structure their income stream to suit their needs. Pensions with defined benefit characteristics provide certain characteristics not provided by allocated pensions and TAPs (the above are but a few examples). We are of the view that life-time pensions (and fixed term/fixed payment pensions) still fill a valuable role in the retirement plans of many retirees.

### **1.3 Choices available where an allocated pension or TAP does not meet their needs?**

For the vast majority of people for whom an allocated pension or TAP does not meet their retirement needs, the only other options under the current SIS Regulations (post 30 June 2005) would be to:

- (a) purchase a retirement product through an institution; or
- (b) take their money as a lump sum.

We do not believe that the lump sum option is in the longer term interest of protecting Government revenue. We believe that the emphasis should be on promoting a retirement income, not a lump sum which, after being exhausted, will usually result in the retiree falling back on the public purse.

For a number of people, purchasing a product through an institution is not considered an attractive option for a variety of reasons. There are over 500,000 people currently in small superannuation funds because they prefer these arrangements to the other products available in the market. Institutional products certainly have their place, but they do not suit everyone. In terms of post-retirement products, annuities in particular are often not perceived to offer value for money. The need to charge high risk premiums to protect the institution against both investment and mortality risk, as well as to provide profit margins, results in pricing which is perceived to be unfavourable to the average retiree.

Furthermore, many retirees who have saved all their working life may be unwilling to risk leaving the capital remaining on their death to a large institution, rather than to their dependants. On face value, the recent changes to the SIS Regulations increasing the allowable guarantee period from 10 years to the lesser of life expectancy or 20 years may appear to help address this concern. However, in practice, this change may have very limited impact on the attractiveness of annuities, as a higher guarantee period will necessarily result in a lower initial income stream for a given purchase price. Consequently, the “value for money” perception may become even worse, not better.

If the Government wishes to encourage community pooling of mortality risk via life office annuities, we believe it will need to find other ways to do this, rather than simply banning lifetime pensions from small funds.

## **2. 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 could be adequately addressed by making certain modifications to the existing rules for life-time and fixed term pensions (within the meaning of SIS Regulations 1.06(2), (3), (6) and (7)), rather than applying a blanket ban for small superannuation funds.

## **2.1 Concern 1(a): Access to unintended tax benefits, particularly from the use of “RBL compression”**

The following section addresses in particular the issue relating to “RBL compression”. Other issues relating to level of income drawn or assets remaining within a fund are dealt with under the estate planning concerns later in this submission.

When assessing a life-time pension for RBL purposes, the ATO uses a series of valuation factors set out in Schedule 1B of the Superannuation Industry (Supervision) [SIS] Regulation 1994 to calculate the value of the pension. In many cases, these factors considerably understate the true value of the pension in the current economic environment, giving rise to an RBL value which is often lower than the actual purchase price of the pension. This does not necessarily require any manipulation or abuse of the rules by the retiree – it is just the way the rules currently work.

We also note from the recent Senate hearings Treasury’s concerns that the use of large amounts of undeducted contributions can also give rise to a lower RBL value. Although, as an Institute, we do not know how prevalent this is in practice, we acknowledge that the current formula does give rise to the opportunity to achieve this, should a retiree have the willingness and resources to do so.

### *Possible solutions*

We are of the opinion that these concerns could be addressed by one or more of the following:

- (a) Updating the SIS Schedule 1B factors to better reflect the true value of a life-time pension.

Although this would affect members of both large and small funds, the current SIS Schedule 1B factors are understating the value of a life-time pension payable from every fund, not just small funds. Consequently, RBL compression is actually occurring with life-time pensions provided from both large and small funds. If the Government is concerned with RBL compression, then it is reasonable to argue that the same rules should apply to all life-time pensions, regardless of what type of fund they are being paid from.

In updating the factors, the following should be taken into account:

- Using more recent Australian Life Tables to reflect current and expected mortality and life expectancy rates;
- Reviewing the economic assumptions used in the calculation of the factors to ensure that they are reasonable in the current economic environment;

- Taking better account of the ages of any reversionary beneficiaries (at the moment, a 40 year old reversionary is treated the same as an 80 year old reversionary under the SIS Schedule 1B tables);
  - A mechanism to review the tables periodically to ensure they remain up-to-date (eg review the factors when new Australian Life Tables are published every 5 years).
- (b) In terms of the use of large undeducted contributions, manipulation of the RBL value can only occur because the current SIS Schedule 1B factors understate, in some cases significantly, the true value of the pension. If the SIS Schedule 1B factors are updated to better reflect the true value of a pension, the ability to compress the RBL value via large undeducted contributions will be very limited. Consequently, updating the SIS Schedule 1B factors may be an adequate step to also resolve this issue.

However, if the Government did not believe that updating the factors on their own would be sufficient to address the concerns over the use of large undeducted contributions, then the RBL formula could be amended to ensure such manipulation did not occur. For “purchased pensions”, the RBL formula could be amended as follows:

$$A = (\text{Annual Pension} \times \text{PVF} + \text{RCV})$$

$$B = \text{UPP} \times A / \text{Purchase Price}$$

$$\text{RBL Value} = A \text{ less lower of } (B \text{ or UPP})$$

This ensures that the addition of undeducted contributions has no effect on the RBL capital value of the pension.

For example:

	<b>Example 1</b>	<b>Example 2</b>
Taxable conts	\$1m	\$1m
Undeducted conts (UPP)	-	\$2m
Purchase Price	\$1m	\$3m
Annual pension	\$60,000	\$180,000
SIS 1B PVF	14	14
RCV	nil	nil
A (from above)	\$840,000	\$2,520,000
B (from above)	\$-	\$1,680,000
RBL value (A less B)	\$840,000	\$840,000

The proposed adjustment to the RBL capital value formula ensures that large amounts of undeducted contributions do not have any impact on the assessable value for RBL purposes.

The term “purchased pension” is already defined within several tax rulings relating to fixed term pensions. A similar definition could be adopted for the purpose of the above. In order to ensure that the definition was watertight, the Government could consider defining a purchased pension to be:

- Any pension funded by an identifiable account balance on commencement (or words to this effect); or
  - Any pension provided through an self-managed superannuation fund (SMSF) or small APRA fund (SAF). Where there is no identifiable account balance on commencement within the SMSF or SAF, the purchase price could be defined as the member’s actuarial reserve in the fund (or words to similar effect).
- (c) An alternative would be to amend the assessment of purchased life-time pensions so that the full purchase price is counted for RBL purposes, in much the same manner as applies to a purchased fixed term pension under TD 2000/29. For example:

$$\text{Capital Value} = \text{Purchase Price} - (\text{Undeducted Contributions} + \text{Concessional Component} + \text{Invalidity Component})$$

Although this is a simpler amendment, it does not have any impact on the undervaluation of pensions in larger superannuation funds for RBL purposes.

Where part of the purchase price is held as a solvency reserve (eg to meet the high probability requirement for Centrelink purposes), then some consideration may need to be given as to whether the solvency reserve should be excluded for the purpose of the above formula, as is currently referred to for fixed term purchased pensions under ATO TD 2000/29. If the solvency reserve was to be excluded, then in order to avoid undesirable RBL manipulation, we would suggest that a measure also be put in place (as discussed in the next section) to ensure that the initial level of income on commencement is reasonable relative to the purchase price (thereby ensuring that the initial solvency reserves are not unreasonably large).

## **2.2 Concern 1(b): Access to Unintended Social Security Benefits**

In terms of access to social security benefits, we note that the asset-test and income rules for social security are effectively the same for small superannuation funds and for life office annuities. Thus the same outcomes can be achieved either through a small superannuation fund or by purchasing a life office annuity, so banning life-time and fixed term income streams from small funds simply moves the problem from one area to another, without dealing with the real issues causing concern.

We would also note that pensions from small funds are already assessed more strictly for social security purposes than life office annuities via the deprivation test. In many instances, the deprivation test can result in part of a small funds assets being subject to the



means test, even though a retiree is paying an income stream that meets the asset-test exempt rules. The deprivation test does not apply to life office annuities.

From the 20 September 2004, the Government has tightened the ability for people to access the social security system by changing the asset-test exemption from 100% to 50% for complying “purchased” pensions commencing on or after 20 September 2004. We are of the view that this change in itself should minimise the ability of wealthy individuals to access the social security system via complying purchased pensions.

If the ban on small funds providing complying life-time and life-expectancy pensions was reversed, consideration could be given to extending the application of the reduced 50% exemption to all complying pensions from SMSFs and SAFs (ie regardless of whether they are “purchased” or not) to ensure that any income streams within a small fund that might fall under the “defined benefit income stream” definition for social security purposes would also be assessed under the 50% exemption. A similar process to the current method of valuing pensions for deprivation purposes could be used to determine the 50% that would be counted for the asset-test.

If the Government is of the view that the reduction in the asset-test exemption to 50% will still not adequately resolve the issue of unintended access to social security benefits, other measures that could be considered include:

- (a) placing a cap on the amount of assets that can qualify for the asset-test exemption. Amounts above the cap would not qualify for the exemption, regardless of the type of product in which they were invested;
- (b) extending the application of the 50% exemption to all complying pensions from all sources, including defined benefit income streams. This change would affect members of larger funds, but would result in all complying pensions being treated the same for social security purposes, regardless of the type of fund that was providing them. In order to administer such a change on an on-going basis, Centrelink would need to place a value on a non-purchased pension in order to determine the 50% that should be counted in the asset test. A similar process to the current method of valuing pensions for deprivation purposes could be used for this purpose;
- (c) amending the income test relating to complying retirement products. A person must satisfy both an income test and an asset test before accessing the social security system. If there are concerns that people are able to gain unintended access to social security benefits, some consideration may need to be given to the income test as well as the asset test. We do not have any particular suggestions in this regard, but simply raise it as a matter to be considered in light of the stated concerns.

## **2.3 Concern 2: Use for estate planning purposes outside of what was intended and not available to other superannuation fund members**

Although the terms of reference do not define exactly what the concerns around estate planning are, we assume that this arises from the belief that some retirees are deferring capital in retirement by drawing a lower pension than can be supported by their assets and building up large reserves over time. It is in this context that we address the above concern.

### **2.3.1 Initial level of income drawing**

Life-time pensions are very different to allocated pensions and TAPs. We are of the view that the mere fact that the initial income level paid under a life-time pension might be lower than what is paid under an allocated or TAP should not be of major concern to the Government – this is a function of the fact that life-time pensions are intended to maintain a certain level of income for life. Allocated pensions, on the other hand, often result in a reducing level of income in old age, while TAPs are designed to last for a nominated term based on life expectancy, not for a person’s entire life.

We acknowledge that under the current legislation, it is possible for a person to draw an unreasonably low pension relative to the level of assets supporting the pension, thereby deferring income and building up reserves. As an Institute, we do not know how prevalent this is in practice. The attraction to do this is, we believe, limited somewhat by the fact that the exemption from tax on the investment income earned on the assets is limited to a “best estimate” value of the pension. Any income arising from surplus or reserve assets is taxed at normal superannuation tax rates. Consequently, the lower the annual pension, the lower the best estimate value of the pension, resulting in more of the income within the fund being subject to superannuation tax each year.

There are a number of different measures that the Government could consider in order to ensure that a reasonable level of income is drawn.

- (a) One of the simplest means of underpinning the initial pension level would be to require, under the SIS Regulations, that if the pension is a purchased pension, the amount paid as the purchase price must be wholly converted into income (ie a return of purchase price test similar to that under the Social Security Act 9A and 9B). Some guidance would need to be provided to confirm how this test is to be measured, in a similar manner to the guidance provided for the Social Security Act provisions. For example, the social security provisions use the payment term for a term pension, or the life expectancy for a person 9 years younger for a life-time pension. This would be a relatively simple mechanism for putting a lower bound on the initial pension level.

Some thought would also need to be given as to how residual capital values (RCVs) are taken into account in this test for SIS Regulation 1.06(6) pensions.

(b) There are also other mechanisms that could be considered for placing a minimum bound on the amount of pension that must be drawn. For example:

- A set of pension valuation factors could be prescribed which define the minimum level of pension that must be drawn on commencement. The valuation basis used to calculate these factors should be reasonably conservative in order to cater for as many different circumstances as possible. For example, the factors could be calculated assuming that a person lived to (say) age 100, invested conservatively (eg 5% cash earning rate), and an appropriate and realistic allowance made for expenses. One set of factors could be calculated using a conservative indexation rate (eg 5% pa), or separate sets of factors provided which vary depending on the indexation rate associated with the pension. Where reversionary beneficiaries are involved, the age of the reversionary (if lower) would be used for the purpose of determining the minimum pension.

A pensioner would have the ability to draw a higher level of income as certified by an actuary depending on their circumstances, investment profile, etc, but would not be able to commence an income stream lower than that obtained using the prescribed factors.

Where factors are being prescribed, a mechanism would need to be in place to ensure that they are regularly reviewed so that they do not become outdated.

- For SMSFs and SAFs, an alternative to prescribing a set of factors may be to consider requiring that on commencement, a pension is not to be commenced at more than a certain level of probability (eg 70% or 80%) of the fund being able to pay the pension, to try to ensure a certain level of income is drawn from the asset available. However, the income level relating to a given probability will vary based on the assumptions underlying the calculations, and consequently, such an approach would be difficult to define precisely and “police” in practice. For these reasons, we do not favour this approach.

These suggestions are more complicated than (a) above. In particular, prescribing pension factors for a minimum pension drawing is likely to introduce additional complexity and regulatory intervention into the process. If the Government’s concerns can be adequately dealt with by other targeted and simpler means (eg such as suggestion (a)), this would be preferable.

(c) Consider placing some limits on the reversionary beneficiaries that can be included in the calculation of the pension. If a pension is payable on death to a young reversionary beneficiary for the remainder of their life, then this can result in a very low initial pension level to the primary beneficiary. Limiting the payment of reversionary pensions to a spouse and/or placing some bounds on the age at which children can receive a reversionary payment (eg up to age 25) may assist in increasing the initial pension level.

- (d) Amending the high probability test for Centrelink purposes from an annual test to a once-off test on commencement. The need to meet the high probability test on an annual basis may encourage people to be more conservative when setting their initial pension level, because if experience is worse than expected and some of the reserves are used, they still have to find extra reserves the following year to continue to obtain a high degree of probability certification. A once-only test on commencement would be more workable, and in our opinion, more appropriate. If a once-off test on commencement was considered appropriate, then the need for an annual high degree of probability opinion under the SIS Regulations should also be reviewed.
- (e) Limit the level of indexation allowed for in setting a life-time pension under SIS Regulation 1.06(2). A life-time pension provided under SIS Regulation 1.06(2) does not have any limit on the level of indexation that can be allowed for when setting the initial pension level, unlike SIS Regulation 1.06(6) and SIS Regulation 1.06(7) pensions. A similar limitation could be required as for 1.06(7) pensions when setting the initial pension level in an SMSF or SAF (being the higher of CPI + 1% or 5% per annum).

However, as discussed in the next section, in order to avoid the build-up of excessive reserves, some flexibility would need to be introduced on an on-going basis to allow a pension to be indexed above the current limits in order to force out additional income over time.

- (f) Limit the level of reserves allowed for in setting up a pension. To a large degree, this would be implicitly achieved by suggestions (a) or (b) above. We have also discussed possible mechanisms for limiting the build-up of excessive reserves in the next section, and these mechanisms could be extended to also apply on commencement.

A combination of the one or more of the above could be used to achieve the desired outcome in relation to ensuring a reasonable initial pension level is drawn. Our preference would be a combination of (a) and (d), with perhaps some consideration given to the issues raised under (c) and (e). (Option (f) can be achieved through a combination of (a) and one or more of the measures outlined below).

### **2.3.2 Maintaining/building large reserves and transferring monies on death**

We understand that the Government is also concerned about retirees building up large amounts of reserves in a tax concessional environment which could be used for purposes other than the provision of a retirement income stream.

As previously explained, the tax exemption on income each year within the superannuation fund only applies to assets up to the “best estimate” value of a pension each year. Consequently, the incentive of building up large reserves within the fund is reduced to some degree by the fact that the income and capital gains on the reserve component (ie the

excess above the best estimate value of the pension) is taxed each year at the superannuation tax rates that apply to non-pension income.

Where an income stream meets the pension RBL standards or asset-test exemption criteria, then by definition, the pension cannot have a residual capital value (RCV). Consequently, after the death of the primary and any reversionary beneficiaries, any remaining assets are forfeited to the fund and become unallocated monies, losing their tax component status in the process (such as any remaining deductible component). Our understanding is that, in general, one of two things can then occur with the residual assets:

- They can be allocated to the account balances of other members within the fund, if other members exist. Some or all of these allocations may fall within the definition of “contributed amounts” under the surcharge legislation and be surchargeable in the accounts of the receiving members. They would also be preserved, ultimately assessed against the recipient’s RBL and taxed as part of their own superannuation benefit when eventually withdrawn as either lump sum or pension; or
- Some trust deeds permit the payment of a death benefit to a dependant or the estate from any residual assets. Since this represents a new benefit (it cannot be part of the original pension, since the pension by definition cannot have an RCV), it is our understanding that the payment of any lump sum benefit would be separately assessed for RBL purposes, and taxed at the appropriate lump sum and/or excessive tax rates. If, for example, a person had already fully utilised their pension RBL on commencing a complying pension, any lump sum benefit paid on death from residual assets would be taxed as an excessive component, regardless of who it was paid to.

Consequently, the attraction for using superannuation as a tax concessional vehicle to build up large reserves for estate planning purposes is limited by the above.

With regard to life-time and fixed term pensions that do not meet the pension RBL standards or the asset-test exempt criteria, the tax status of any residual assets paid on death is less certain, since these types of pensions are permitted to have an RCV component under the legislation.

Notwithstanding the above comments, if the Government remains concerned that defined benefit pensions are being used for estate planning purposes outside of its intentions, we suggest that consideration be given to one or more of the following measures:

- (a) For pensions that do not meet the pension RBL or asset-test exempt requirements, limit the ability to structure residual capital values (RCV) past the compulsory cashing age. We are not referring to the practice of paying out any remaining assets that happen to be in the fund on death, but the ability under the current legislation to defer drawing on the accumulated superannuation balance by specifically allocating part of it as an RCV. For example, it is possible to structure a pension under SIS Regulation 1.06(6) with 100% RCV payable on death, with the pensioner effectively only drawing down the earnings on the asset each year. Such practice

would seem inconsistent with the compulsory cashing rules, and the Government's concerns about estate planning. An amendment to the provisions of SIS Regulation 1.06(6) could address this.

- (b) For SMSFs and SAFs, the Government could introduce a mechanism which limits the build up of excessive reserves in a fund by forcing out additional income in the form of increasing the annual pension payment if the reserves exceed a certain level (eg due to good investment performance). Conceptually, this could be achieved by requiring that if the net assets supporting the pension exceed the best estimate value of the pension by more than an allowable percentage (X% as a percentage of the value of the pension) at the most recent actuarial review, then the pension must be adjusted so that the assets do not exceed the value of the pension by more than X%.

This could be achieved in several ways:

- *Method 1 – Forcing an increase in the on-going indexation rate.* Under this approach, the actuary would advise the “additional indexation rate” that is to be funded out of the excess reserves over the remaining term of the pension, and these increases would be applied in addition to the indexation that was nominated at commencement (eg the “nominated indexation rate”). Any excess reserves would then be paid out in the form of additional pension payments in future years, rather than just being left to accumulate within the fund. If investment performance turned down, the “additional indexation rate” could subsequently be reduced or removed based on the actuary's advice. Where the nominated indexation rate was positive, it may even be reasonable to set the additional indexation rate negative (subject to the limit of the nominated indexation rate so that the dollar amount of the pension was not reduced from year to year).

Forcing increases in the on-going indexation rate will help to control the build-up of excessive reserves by requiring additional income to be drawn over time, and will also help to maintain reasonably stable pension levels from year to year, since any excess reserves are forced out over the remaining term of the pension via increased pension payments.

- *Method 2: One-off adjustment to the annual pension level.* As an alternative to forcing an increase in the on-going indexation rate, a requirement could be introduced to force a one-off increase in the annual pension payment in the following year so that the value of the assets did not exceed the value of the pension by more than X%, with indexation in future years continuing at the same rate as originally nominated on commencement. In effect, this method would result in one-off jumps in the pension level whenever the reserves exceeded the nominated percentage, rather than the gradual indexation under Method 1.

For the purpose of illustrating the difference between these two methods, assume a pension has been running with a nominated indexation rate of CPI each year.

Suppose that the Government has set the maximum percentage by which the assets may exceed the value of the particular assumed pension at X% (consideration of the appropriate limit or limits will need to take place and we provide some further comments on this below). If, after an actuarial review, the assets exceed the best estimate value of the assumed pension by X+10%:

- Method 1 might result in the ongoing indexation rate increasing from CPI to CPI + (say) 1% per year to increase the best estimate value of the pension to within X% of the value of the assets, gradually forcing out the excess reserves over time; while
- Method 2 might result in a 10% increase in the pension payment the following year in addition to the nominated CPI increase to increase the best estimate value back within X% of the assets, with only the nominated CPI increases thereafter.

Since the level of reserves can move up and down over time, depending on movements in the underlying asset values, Method 1 is preferable from a funding perspective as it would result in less volatility in the year-to-year pension payments than Method 2. Method 1 is likely to be preferred by retirees who are also receiving Centrelink benefits because the changes in pension amount will have less impact on the result of the income test than under Method 2.

Such a mechanism would ensure that any reserves are maintained within reasonable bounds over time. Since the best estimate value of a pension will usually reduce over time (as the pensioner ages or the remaining term reduces), such a mechanism would ensure that any reserves are “forced out” as income on a regular basis if the experience of the fund is as good as, or better than, assumed.

Such a mechanism may also be attractive to many retirees. The building-up of large reserves is not necessarily something that is desired by a retiree, particularly those on average levels of income. It is something that just happens under the current legislative rules if a fund’s experience is better than assumed. A mechanism as described above would assist both the pensioner in using the reserves to draw additional income if experience is better than expected, as well as address the Government’s concerns about the accumulation of large reserves for estate planning purposes.

In order to accommodate the above, the existing cap on the allowable indexation rates under SIS Regulations 1.06(6) and 1.06(7) would need to be amended to allow the pension to be increased above these rates if required to meet the above, as well as the caps currently in place under Social Security Act 9A and 9B.

Some consideration may also need to be given to allowing the annual pension drawing to be reduced at a later date if the value of the assets subsequently falls below the value of the pension in order to maintain the solvency of the pension. This would allow for a balanced approach to the management of reserves, so that the

pension can be either increased or decreased to ensure that reserves are managed within reasonable bounds.

The above methods of restricting the build up of excessive reserves will remove the ability for people to commence unrealistically low pensions on commencement. Consequently, it may not be necessary to place a minimum bound on the initial pension level as discussed in the previous section if a mechanism to control the level of reserves was introduced.

#### *Setting a limit on reserves*

The allowable percentage X% (ie the maximum level of reserve) would need to be high enough to allow for a fund to manage both increasing longevity risk and the volatility of investment market returns. For the sake of presenting an example, assume a maximum reserve of 50% was agreed upon. If the purchase price of a pension was \$750,000, this would mean that the pension level would need to be such that the best estimate value of the pension was no less than \$500,000 on commencement. If, one year later, the level of assets had increased to \$900,000, then the pension would need to be adjusted so that the best estimate value of the pension was no less than \$600,000 (for example, under Method 1 the on-going indexation rate would need to be increased). This would effectively force more income out via increased pension payments each year, reducing the level of assets in subsequent year.

The allowable percentage above which reserves would be considered “excessive” would need to be wide enough to cover the high probability reserve for such pensions. A percentage of 10% or 20% would not be sufficient to provide for a high probability of payment for a life-time pension, when the level of reserves required for high probability (70%) purposes are more likely to be in the range of 30-40% (or more in some cases).

Alternatively, rather than setting the maximum reserve level around the best estimate, the level of assets could be compared to the high probability value of a pension and a more narrow range set around the high probability value. However, an exact high probability value can be more difficult to define in practice than a best estimate value (since it is based on additional assumptions). Consequently, managing the reserve around a best estimate value is likely to be more practical to define and implement.

Institute Guidance Note 465 provides guidance to actuaries in defining and calculating a high probability value. We would be willing to assist you in defining what is meant by the term “best estimate value of the pension” to avoid any mis-interpretation of this phrase.

- (c) Rather than attempting to control the build up of excessive reserves each year, the Government could consider introducing an additional tax that applies to the residual assets of a pensioner which are allocated to members’ accounts or a reserve



following the cessation of a pension. However, such provisions would have to be carefully drafted to ensure that there were no unintended consequences on other superannuation arrangements, which could be difficult to achieve. Given the complexity of the current tax rules, this would add a further level of complexity which is undesirable, and consequently, we do not favour this approach. Our preferred approach to addressing the Government concerns would be to limit the ability to accumulate excessive reserves and address the RBL compression issue – additional taxes on residual assets would then not be required. Also, for consistency, we note that allocated pensions and TAPs do not have additional taxes applied to their residual assets on death.

#### **2.4 Concern 3: Whether small number of members can effectively pool risk and guarantee income payments**

The concern regarding the ability to pool risk and guarantee income payments arises, we believe, from a prudential standpoint (as opposed to the concerns above which arise from a revenue standpoint).

As compared with traditional defined benefit lifetime pensions (provided by corporate or public sector employer-sponsored superannuation funds or life offices):

- (i) SMSF's and SAFs are unable to use pooling of lives to manage mortality risks;
- (ii) SMSF's and SAFs usually have no guarantor to support payment of the pension should there be poor investment experience and/or the pensioner lives longer than the money lasts.

We consider that these differences should be (and are in general) well understood by pensioners from these small funds and we have provided comments below on ways in which these risks are currently being managed by small funds. However, given these differences – in particular (ii) – it may be appropriate to consider a different name for the SMSF and SAF version(s) of defined benefit pensions. This may assist in avoiding any confusion over the characteristics of SMSF and SAF pensions and enable prudential and other controls to be targeted specifically at these pensions having regard to their characteristics. For example, a name such as 'Re-settable Lifetime Pensions' would clearly convey the message that the amount of the pension is not guaranteed and that this pension is different from a traditional defined benefit lifetime pension.

We do not believe that the fact that they can't be guaranteed justifies a ban on small funds providing such pensions. Rather, this is a feature to be taken into account in deciding if, and under what terms, an SMSF or SAF version of defined benefit pensions should be allowed to continue. As with larger funds, reserving techniques are used in small funds to manage investment risk, and to help manage longevity risk. In most cases, this invariably involves setting aside a portion of the purchase price to act as a buffer or reserve against adverse experience. In some annuity designs, life offices use variable bonus structures to help cover their investment and longevity risks - small funds can also replicate this arrangement by providing for variable indexation, which can be adjusted in light of

emerging experience. Small funds are also the subject of annual actuarial review and control.

We note that the legislation currently allows a pension to be commuted and repurchased if the need ever arises to adjust the pension level due to poor experience or other circumstances. Consequently, there are mechanisms in the current legislation which allow a small fund to manage these risks. However, the recent regulation changes made on 12 May 2004 (and associated transitional arrangements), in conjunction with the draft ATO determination SD 2004/D1, will make it more difficult for existing defined benefit pensions to use this mechanism after 1 July 2005.

We would also make the following points relating to the concerns raised over the lack of ability for small funds to “pool risk” and “guarantee income payments”:

- Defined benefit pensions are often compared to allocated pensions and TAPs in relation to concerns over the pooling of risk and guaranteeing payments. In fact, at the recent Senate hearings, a statement was made that *“There is no risk that they [allocated pensions and TAPs] will not be able to deliver what they promise...”* when highlighting the differences between the risks of a defined benefit pension and account based pensions. To the self-funded retiree using their own superannuation fund to pay an income stream, the practical risks are remarkably similar. If the pensioner loses 50% of their assets, then regardless of whether they are paying themselves a TAP or a defined benefit pension, they are invariably going to need to reduce their income drawing. The difference is the method of adjusting the income level - TAPs have a simple mechanism for adjusting the income stream, while a defined benefit pension has a more complex mechanism (via a commutation and repurchase).
- In fact, from the pensioner’s perspective, in many cases defined benefit pensions assist them to better manage their risks. Defined benefit pensions usually hold reserves to help manage the risks. In terms of investment risk, the impact of a fall in the value of a fund’s assets can be cushioned by the reserves being held within the pension, assisting the pensioner to maintain the same level of income. In the case of a TAP, the pensioner will feel the full effect of short-term market movements the following year via a reduction in their income drawing. In terms of longevity risk, unlike a defined benefit pension, a TAP does not even attempt to maintain payments for the remainder of a person’s life – at the end of the nominated term, the pension will cease. A defined benefit pension helps the pensioner to manage this risk by smoothing the pension payments over a longer period and reserving for longevity risks under the control of an actuary.
- While it is true that even though the risks are managed they are ultimately borne by the members of SMSFs and SAFs, members should enter into these arrangements in full knowledge of these risks. This applies whether the member is using an allocated pension, TAP or defined benefit pension within their SMSF or SAF. There are no “public protection” issues for these types of funds. These members have made a conscious decision to bear any risks that arise, rather than pay an

institution to bear these risks for them. The majority of Australians bear all of the risks in the accumulation phase of their superannuation and will continue to do so in retirement phase if they choose a TAP or an allocated pension, so it is difficult to see why this is considered so undesirable with the small fund version of a defined benefit pension.

- If members of SMSFs and SAFs are not permitted to provide their own life-time pensions, the only option for most retirees to obtain a pension payable for life is to purchase an annuity from a life office. Annuities, however, are not perceived as offering value for money – yet, if you take away the ability to pay a life time pension from a small fund, this leaves the retiree with no other option to provide a life-time income stream.
- The terms of reference specifically mention pooling of risk. However, pooling of lives does not address the very significant risk of increasing longevity. Pooling among a large number of pensioners helps to spread the risk of some members living longer than others by using the residual capital of those who die early to help fund those who die later. But pooling does not address the risk of all of the lives in the pool living longer. Consequently, pooling is not the answer to the issue of increasing longevity.

The issue of “liquidity” risk has also been raised in the terms of reference for the review. However, liquidity risks are relevant to all superannuation funds, not just those paying defined benefit pensions. In fact, funds that pay lump sum benefits and pensions which can be commuted (such as allocated pensions) in a commercial environment can represent a greater liquidity risk than non-commutable defined benefit pensions being paid from small funds, since the cashflow requirements are more lumpy and timing is more uncertain. With a defined benefit pension, the cashflow requirements are more certain (ie regular payments of fixed amounts each year) and therefore, more easily planned for. In this respect, it could be argued that there is actually less liquidity risk associated with a non-commutable defined benefit pension than an allocated pension where lump sum withdrawals are permitted.

TAPs can also represent a very significant liquidity risk in any type of fund, and are possibly one of the most difficult type of pensions to manage from a liquidity perspective due to a combination of (a) the drawdown of capital being completely exhausted over the nominated term, (b) the inability to vary payments within a minimum/maximum range and (c) the volatility of payments that can occur from year to year if the investment experience of the fund is volatile (ie there is no stability in the annual income payment if the assets are rising or falling).

The issue of liquidity risk is one which faces all superannuation funds. Small funds can invest in large pooled products just the same as large superannuation funds, as well as listed shares and other liquid investments. Small and large funds can also invest in less liquid investments, such as property, unlisted shares, infrastructure pools, hedge funds, etc. In our opinion, it would be more appropriate to deal with management of liquidity risks

through the investment strategy requirements of the SIS Regulations, rather than banning certain funds from providing certain types of benefits or income streams.

Consequently, we consider that there are techniques available to assist SMSFs to effectively manage their risks while recognising that there is no guarantor standing behind them and there are circumstances where pension payments may need to be “re-set” from time to time should experience be worse than expected.

### *Suggested improvement for managing risks*

The legislation, together with available investment products, already allow small superannuation funds to manage their risks reasonably effectively. Further, a specific mechanism also exists in the legislation to allow a small fund to adjust the level of a defined benefit pension if ever required (in the form of commuting and repurchasing). However, in the absence of a re-design of the small fund version of defined benefit pensions (as discussed below), we believe that a simpler and more efficient mechanism should be introduced. This could be achieved by allowing a pension to be reduced on the advice of an actuary where this was required to maintain the fund in a satisfactory financial position, as defined under Section 130 of the SIS Act and Part 9 of the SIS Regulations. This would help to avoid the more cumbersome process of commuting and repurchasing, whilst minimising any opportunity for potential abuse of the increased flexibility. In order to protect non-arms length members in larger funds, we suggest that this mechanism only apply to “purchased pensions” (refer to previous sections of our submission), and only where the written consent of a pensioner has been obtained prior to any reduction in the pension level.

### **3. Alternative Pension Designs**

While we believe that a combination of the above measures will address the concerns raised by Government, the SMSF and SAF version of defined benefit pensions could be re-badged (eg a “Re-settable Lifetime Pension” as suggested earlier in this paper) and/or re-designed. Other pension designs could also be considered to complement the existing suite of defined benefit pensions, allocated pensions and TAPs provided for under the current legislation.

We put forward the following alternative pension designs that may be worthy of further consideration:

- (a) A life-time allocated pension. Conceptually, this would look similar to an allocated pension structure, but with the following exceptions:
  - The pension would be non-commutable;
  - The pension would attract complying status for taxation and social security purposes;

- The minimum and maximum pension valuation factors would be set in such a way that a person has a high degree of probability of maintaining their initial pension level in real terms for life. For example, the factors used to calculate the maximum pension drawing at each age could be based on a best estimate or 50% probability basis, while the factors used to calculate the minimum pension at each age could be based on a high degree of probability (eg 70% or 80% probability) of paying the current real pension level for the remainder of a person's life. Realistic assumptions would need to be made regarding investment returns, expense levels and future mortality improvements.

This type of structure would allow a person to draw an income payable for their lifetime. Appropriately determined minimum and maximum factors will also assist the pensioner in obtaining some stability in their year-to-year pension drawing level, which is not possible with the existing TAP structure. The use of minimum and maximum factors should help to limit the build-up of excessive reserves, addressing the Government's concerns over estate planning, while the account-based structure of the pension removes any perception that payments are guaranteed, with all of the risk being borne by the pensioner. The use of the purchase price for RBL purposes would also remove any concerns regarding RBL compression issues. As with the existing allocated pension structure, there would be no need for legislated actuarial involvement.

However, prescribing the pension valuation factors would mean that the structure may not be flexible enough to suit the needs of everyone. For example, a prescribed set of pension valuation factors will not necessarily cater for:

- people with very good or very poor health;
- different indexation rates to suit different people's needs – eg nil indexation for people who need more income now or who have income from other sources; CPI or CPI+1% indexation for people who want to maintain their real level of income in retirement; 5% or higher indexation for retirees who are happy to take a lower income now but a higher income later in life (eg when medical expenses may be expected to consume a greater proportion of their weekly costs);
- differing risk/return profiles which affect how people invest their assets and therefore, the expected future earnings on those assets;
- differing expense/cost structures between funds;
- partial reversionary beneficiaries (eg 100% to primary and 50% to spouse).

Prescribing a set of pension valuation factors would also require the factors to be updated from time-to-time to reflect changes in economic conditions and improvements in mortality to ensure that they remain current and relevant to retirees.

Given that both the general RBL pension valuation factors and the allocated pension minimum/maximum factors have not been updated in over 10 years, it is likely that updating any prescribed factors would not receive a high priority in practice.

In contrast, the regular actuarial involvement in the monitoring and review of defined benefit pensions ensures that assumptions are regularly reviewed and updated, and can be tailored to suit the individual circumstances of individual retirees.

- (b) Increasing the flexibility in the existing TAP structure. Specific enhancements to the current rules for TAPs could include:
- Allowing a pensioner to choose a longer term on commencement to cover increasing longevity risk, such as a term which takes them up to age 100 or such longer age as allowed (age 110 is the oldest age in the current life expectancy tables);
  - Providing minimum and maximum pension valuation factors to apply for TAPs in a similar manner as described above for the life-time allocated pension (but with a narrower range since longevity risk does not need to be allowed for) so that people can try to maintain a stable income level from year-to-year. In this case, best estimate and high probability factors would be used for the remaining term, rather than entire life-time.

For the same reasons as outlined for the life-time allocated pension structure above, a more flexible TAP structure could be achieved without compromising the concerns raised by the Government over access to unintended tax consequences, estate planning and guaranteeing of income payments. Again, no legislated actuarial involvement would be required with such a structure.

However, prescribing the pension valuation factors results in the same drawbacks as outlined above for life-time allocated pensions.

- (c) Alternative life-time pension: Design 1. Conceptually, an alternative life-time pension structure which could be considered is as follows:
- Each year, a “target pension” would be calculated by the actuary, based on the remaining assets in the fund. In principle, the target pension would be a term pension based on the pension being payable until the youngest pension/reversionary reaches the limit of the current life tables (eg age 110). In calculating the target pension, a target indexation rate would be nominated by the retiree at the outset, and the actuary would select assumptions based on the profile of the pensioner for future investment returns and expenses, on a best estimate basis (as is the case for the tax exemption calculation). This would ensure that the target pension is flexible enough to cater for the individual circumstances of each client. We would envisage that the process for calculating the target pension could be legislatively prescribed, but not the actual pension valuation factors used to calculate the target pension, to ensure

that the target pension can be tailored to the circumstances of each individual retiree.

- On commencement, the actual pension level would be the target pension that can be supported by the purchase price (for example, the purchase price divided by the relevant pension valuation factor for the target pension at commencement, where the valuation factor is calculated by an actuary in line with the above criteria and based on the individual circumstances of the retiree).
- Each year (eg at 1 July), the target pension level is recalculated as the assets divided by the relevant factor for the remaining term:
  - If the actual pension level is within a nominated rate (say X%) of the target level, then the actual pension is indexed as originally intended.
  - If the actual pension level is above the target level by more than X%, then the actual pension level should remain constant (ie not indexed).
  - If the actual pension level is below the target level by more than X%, then the actual pension must be adjusted upwards to bring it within the range.

These adjustments help to both manage the investment risk, as well as smooth the impact of any short-term rises or falls in the value of the assets. During periods of poor performance, the pension level would be held constant (ie not indexed) to help maintain solvency levels. During periods of strong investment performance, the pension would be increased above the target indexation rate to limit the build up of excessive reserves.

- The use of an old age in setting the target pension level (eg 110) helps to manage the risk of increasing longevity. A younger age could be used, depending on the balance that the Government considers is appropriate between security (a low probability of having to reduce the pension because the pensioner lives 'too long') and deferral of income (due to holding reserves that may never be required).
- The tax exempt amount of assets would be determined actuarially on a best estimate basis, based on the actual pension level and probabilities of survival. Because the target pension does not allow for death until very old age (eg 110), there would usually be taxable reserves each year in the fund (the difference between the value of the term pension to age 110 and the best estimate value of the pension based on probabilities of survival). This helps to balance the revenue impact with the desire to hold reserves to manage the various risks.
- The pension would still need to meet the requirements of Section 130 of the SIS Act relating to satisfactory financial position on a best estimate basis. If simply holding the pension at its current level is not sufficient to ensure that the

best estimate value is covered by the remaining available assets, the pension level would then need to be reduced to return the fund to a satisfactory financial position.

- In terms of the benefit payable on death:
  - If the full purchase price was reported for RBL purposes on commencement, any residual assets could be paid out as a death benefit.
  - If the reported RBL value on commencement was less than the purchase price (eg SIS 1B factor x initial pension level), then a death benefit calculated as *annual pension level at the time of death x SIS 1B factor at the time of death* could be permitted. Any residual assets above this level would be separately reportable for RBL purposes if paid out as an additional death benefit.

Conceptually, this structure is a little more detailed than the previous suggestions. However, it is effectively just a self-adjusting life-time pension, where the adjustments are smoothed over time so the pensioner can maintain some stability in their income level from year-to-year. Basing the target pension on a term into old age (eg 110) will help to offset the risks of improving longevity, but balancing the revenue impact by only allowing a tax exemption on income up to the best estimate value of the actual pension being paid.

From a prudential perspective, the use of an “old age” in calculating the target level helps the pensioner to manage the risks of longevity, and an appropriate allowable range around the target level assists with managing fluctuations in the underlying asset values arising from investment risks. Any residual prudential risk is addressed via the ability to reduce the pension if ever required (the self-adjusting nature of the structure).

The adjustment of the actual pension level around the target level each year also helps to minimise the build-up of excessive reserves by forcing out additional income (in the form of higher pension payments) if the actual pension level falls below the target level by more than the allowable range.

Allowing the actuary to calculate the target pension level, based on the individual circumstances of the retiree, enables this pension to be flexible enough to cater for different investment/risk profiles of clients, differing needs in terms of indexation rates, etc, whilst addressing the concerns raised by the Government.

- (d) Alternative life-time pension: Design 2. Conceptually, this would operate as follows:
- Essentially this is a pension where the level of indexation would be varied (generally between nil and 5% pa) under actuarial control to maintain a reasonable degree of probability that the pension will be able to be paid as defined while not allowing reserves to build beyond a maximum level.



- The initial amount of the pension would be required to fall between a minimum and a maximum determined by the purchase price.
- The minimum would be the purchase price divided by the pension valuation factor representing the best estimate value of the chosen pension assuming indexation at 5% pa.
- The maximum would be the purchase price divided by the pension valuation factor representing the best estimate value of the chosen pension assuming zero indexation.
- The best estimate pension valuation factors would be calculated by the actuary, based on the individual circumstances of the retiree (such as expected earning rate based on their investment profile, level of expenses, level of reversion, etc) and payable for a term period (see next point).
- A longevity reserve could be allowed for by assuming that the pension is payable for a term of (say) 1.5 times the life expectancy for the primary beneficiary and then a reversionary pension (if applicable) for a term of 1.5 times [the life expectancy for the reversionary beneficiary minus the life expectancy for the primary beneficiary]. A suitable multiplier of the life expectancy would need to be determined for this purpose. The pension payment term would be recalculated each year, based on the pensioner's life expectancy at the time of valuation.
- Each year the pension would be indexed by between zero and 5% pa, as determined by the pensioner based on the Actuary's advice, with an adjustment outside this range (a re-set) permitted only if required so that the pension remains between the minimum and maximum (calculated in a similar manner as the process at commencement).
- A re-set could be required to be notified to DFACS, if considered appropriate, for social security pensioners.
- Less frequent actuarial reviews could be required under this structure (say, three yearly), perhaps subject to "notifiable events" requiring earlier re-assessment (eg. death of the primary or reversionary beneficiary or investment return outside a range specified by the actuary).

The use of minimum and maximum pension drawings, calculated with reference to the account balance each year, will limit the ability to build-up large reserves, thereby addressing Government concerns over estate planning. Basing the term on a suitable multiplier of the life-expectancy, together with the range in the minimum and maximum valuation factors, will assist the pensioner in managing the

appropriate risks, while the ability to adjust the pension either up or down should remove any residual concerns from a prudential perspective.

We would be happy to flesh out and provide illustrations of the above concepts should the Government be interested in considering any of them further.

## Summary

As should be evident from our submission, we believe that the Government's concerns regarding the provision of defined benefit pensions from small funds can be adequately addressed by targeted amendments to the current rules relating to defined benefit pensions, without the need for wholesale design changes. For example, we believe a combination of the following would adequately address all of the concerns raised by Government:

- (a) modifying the calculation of the RBL capital value to avoid RBL compression;
- (b) inserting a return of purchase price test into the requirements for purchased defined benefit pensions;
- (c) simplifying the mechanism for allowing a purchased defined benefit pension to be reduced if ever required for solvency purposes;
- (d) introducing a mechanism to limit the build-up of excessive reserves supporting a purchased pension; and
- (e) considering a limitation on structuring RCVs for SIS Regulation 1.06(6) pensions past the compulsory cashing age, as well as possible restrictions on reversionary pension beneficiaries.

Points (a) and/or (e) could be applied either for all defined benefit pensions or just "purchased pensions", while (b), (c) and (d) would be more appropriate to be restricted only to "purchased pensions".

We also believe a "re-badging" of SMSF and SAF defined benefit pensions may be worthy of consideration in order to distinguish them from traditional defined benefit pensions and allow better targeted design and prudential controls.

From a simplicity of implementation point of view, the simplest amendments required to address the Government's concerns would be as follows:

- (a) base the RBL capital value calculation for purchased pensions on the purchase price – this would involve a relatively simple legislation amendment and some simple wording changes to the current taxation ruling TD 2000/29 to expand the current wording to apply to both life-time and fixed term pensions. This would address the RBL compression concerns relating to small funds, but would have no impact on the undervaluation of pensions from larger funds;
- (b) replicate the existing return of purchase price test currently in the Social Security Act into the SIS Regulations for purchased pensions – this would ensure that a

minimum level of pension must be drawn on commencement and will help to address any estate planning concerns;

- (c) allow a purchased defined benefit pension from an SMSF or SAF to be reduced if required on the advice of an actuary and subject to agreement from the pensioner. This should not be a difficult drafting amendment and would address the prudential concerns.

We have also suggested including a mechanism for limiting the build-up of excessive reserves within the SIS Regulations for pensions provided from SMSFs and SAFs if the Government is not satisfied that the current taxation rules applying to these reserves is sufficient to address its concerns. Although more difficult to define than the first three suggestions above, we believe that an appropriate mechanism could be implemented with careful thought and consultation. We would be willing to assist the Government in drafting appropriate wording if desired.

If considered desirable by the Government, limitations on structuring RCVs past the compulsory cashing age for SIS Regulation 1.06(6) pensions could also be achieved with relatively simple amendments to the SIS Regulations.

We believe that life-time and, in some cases, fixed term (fixed payment) pensions fill a valuable niche in the retirement income stream market for retirees, and meet the needs of certain retirees that other income stream products do not fulfil.

Many retirees do not have the skills to manage the level of income they should be drawing from their capital in retirement to ensure, as far as possible, their capital lasts for their remaining life. Defined benefit pensions provide an automatic mechanism to assist the retiree in this regard through the ongoing actuarial review and monitoring process and therefore fill an important role in the retirement income stream options for retirees.

We believe that the Government should be seeking to encourage people to draw on their superannuation via an income stream in retirement, rather than a lump sum. Defined benefit pensions can not only assist in meeting this objective, but also help to ensure that there is a reasonable range of income stream choices available to people in retirement.

Other product designs may also enhance and complement the options available for retirees, but do not, in our view, necessarily replace the role filled by defined benefit pensions.

We would be happy to work with the Government to ensure effective implementation of these, or any other suitable measures, in order to adequately address the concerns raised.