CPA Australia
ABN 64 008 392 452

Level 8, 161 London Circuit
Canberra ACT Australia 2601
T +61 2 6267 8585
F +61 2 6267 8555
E michael.davison@cpaaustralia.com.au
W www.cpaaustralia.com.au

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

Email: dbpensionreview@treasury.gov.au

Dear Mr Coles

Review of the provision of pensions in small superannuation funds

CPA Australia welcomes the opportunity to make a submission on the discussion paper released as part of the above review.

General comments

CPA Australia recognises and acknowledges there are shortcomings in the superannuation system as a whole that have been highlighted in recent times with the increased focus on self managed superannuation funds (SMSFs). However, the May 2004 prohibition on small funds providing defined benefit pensions (which significantly impacts on SMSFs) did not directly address the issues concerned, instead it has reduced choice for many Australians, interrupting long-term retirement plans and creating an uneven playing field.

We believe small funds (including SMSFs and small APRA funds (SAFs)) should continue to be able to provide defined benefit pensions. The practices last year's measures attempted to address, such as RBL compression, excessive estate planning and longevity risk, can be addressed with relatively simple changes to existing rules and products without the need of a blanket ban. The issue of inappropriate access to social security has already been addressed with the reduction in the assets test exemption last year.

Treasury's review and discussion paper are positive steps to finding solutions that will allow small funds to continue to provide defined benefit pensions. The following comments are provided to address specific issues raised in the discussion paper.

RBL compression

RBL compression is a product of the existing rules for the calculation of RBLs for lifetime pensions and is available to all superannuation members, not just members of SMSFs. We currently have a situation where the calculation uses an approximation of the purchase price of a lifetime pension, even though the purchase price is known, based on factors that are now 13 years out of date.

CPA Australia strongly supports a combination of the two approaches outlined in the discussion paper. Where the capital value of the amount used to commence a pension is identifiable, as it is in any accumulation fund or when a pension is purchased, there is no reason why it should not be used as the purchase price in the calculation. Where there is no identifiable purchase price, using updated pension valuation factors would ensure all members of all superannuation funds were treated equitably. We agree with the proposal to update the factors in line with each release of the Australian Life Tables.

Estate planning

We agree that excessive estate planning may run contrary to the objectives of the Government's retirement income policy. However, we believe estate planning is an essential part of saving for retirement income purposes to ensure one's loved ones are sufficiently provided for in case of death. This has long been recognised and reflected in the ancillary purposes for superannuation under sub-sections 62(1)(b)(iii) and (iv) of the SIS Act. In addition, with Australians being encouraged to take more ownership of their superannuation benefits through the introduction of fund choice and other measures, Australians will increasingly be concerned about the estate planning issues associated with their superannuation benefits (both pre and post retirement).

As such we are concerned about the underlying tone of the discussion paper that suggests there is no room for estate planning in retirement savings (for example, Section 3 of the Overview).

We believe the concerns around excessive estate planning can be addressed through modifying the existing rules that impact on fund reserves. Tightening the actuarial guidelines so that realistic probability levels are used will ensure excessive reserves are not accumulated. We also suggest the guidelines include disclosure provisions to ensure the assumptions used are properly disclosed for the benefit of trustees and regulators.

To alleviate concerns that reserves remain unallocated within a fund upon the death of the final pensioner to accumulate in a concessionally taxed environment for the benefit of future generations, we suggest any reserves supporting a pension be crystallised upon death and paid out along with any death benefit payable and be subject to the normal ETP treatment.

This will enable Australians to adequately factor their superannuation benefits (both pre and post retirement) into their estate planning.

Managing risk

Contrary to the opening paragraph of Section 5.2.3, we would argue that individual pension members already bear the risk of a defined benefit pension since the defined benefit pension is based upon the member's benefit at the date of the commencement of the pension and the pension benefit is segregated from the accumulation benefits of the other fund members. As such, formal recognition of this is unnecessary and would just add to the complexity of the situation, as would renaming the pensions.

As mentioned above, actuarial guidelines should be tightened, not only to ensure excessive reserves are not accumulated but to also ensure the underlying assets supporting the pension are sufficient for the pension to continue for the recipient's lifetime. The issuing of appropriate and robust guidelines will alleviate the need for additional investment rules in SIS thus avoiding additional complexity and maintaining a level playing field between SMSFs and commercially available income streams.

We are not in a position to comment on the specific content of the guidelines, however we do believe it would be appropriate for the guidelines to be reviewed and updated by the Institute of Actuaries in consultation with the Australian Government Actuary.

With respect to longevity insurance, we believe properly constructed actuarial standards will alleviate the need for such a measure. It is also unlikely the proposed deferred annuities would be an acceptable proposition as the premiums would be seen to be reducing retirement benefits and the same issues around purchasing an annuity from a life office, such as loss of capital on death, would exist. As such, we are doubtful such a product would be utilised.

Extending the maximum term of market linked pensions

The main problem with the current market linked pensions is that they are designed to run out at the pensioner's life expectancy. Given half of the individuals at any given age are expected to outlive their life expectancy, those relying solely on their market linked pension will exhaust their superannuation and then have to rely on the age pension. In this sense, there is greater risk to government expenditure through access to social security than there is with defined benefit pensions.

We support the notion of extending the term of market linked pensions. As it is now, pensioners can choose to use their life expectancy or that as if they were five years younger. This could be extended to also give them the option of choosing to recalculate the remaining term of the pension based on their life expectancy each year. Effectively, pensioners would be able to choose between a life expectancy (fixed term) market linked pension and a lifetime market linked pension. While the lifetime market linked pension would result in a lower annual income, it would reduce the risk of a pensioner outliving their pension with the added convenience of not having to commute and recommence their pension each year.

Updating the basis for allocated pensions

CPA Australia supports the updating of the pension valuation factors for allocated pensions as they are now some 13 years old and do not reflect current life expectancies. We believe it is appropriate to update these factors regularly in line with the release of the Australian Life Tables.

It is important that additional complexity is avoided and thus any updated factors should apply to all new and existing allocated pensions. Such a change would not impact on existing pensioners receiving pension income less than the annual maximum (except those on the minimum who would be able to reduce their level of annual income). However, consideration will need to be given to how such a change would apply to existing pensioners receiving the maximum, or close to the maximum, annual income as their annual income is likely to reduce as a result of the longer life expectancies. Given that the policy intention is for income streams to last longer, this may be an acceptable outcome.

Introducing new pension products

As we believe the modification of existing rules and products will address all of the problems raised by Treasury, we do not believe creating additional products is necessary. The creation of additional products and valuation factors will further add to the complexity of the system at a time when clarity and simplicity is needed.

CPA Australia looks forward to participating further in the review process. Given the complexity and seriousness of the issues being discussed, we strongly suggest a consultative roundtable be held with Treasury and industry representatives before the review is finalised Should you have any queries or require further information, please contact me on (02) 6267 8585.

Yours sincerely

Michael Davison
Superannuation Policy Adviser