smartsuper
superfund administrators

15th July 2004

The Secretary
Senate Economics Legislative Committee
Room SG.64
Parliament House
Canberra ACT 2600

By email: economics.sen@aph.gov.au

Dear Secretary

Re: Issues to consider relating to the announcements changing the ability of funds under 50 members to run defined pensions.

By way of background, Smartsuper is a dedicated Self Managed Fund Administrator. As an organisation, Smartsuper is an active member of the Superannuation Industry Liaison Group (SILG) with the ATO. Smartsuper provides to the Financial Planning Association, training resources for its members on the use of Self Managed Super Funds (DIY funds). Our services are provided to institutions and their clients. These institutions include Commonwealth Bank, Tower, HSBC, Hillross, Financial Wisdom, Smith Barney Citigroup, UBS along with other accounting firms from the very large to small partnerships. We pride ourself in being an administrator of integrity.

I have previously written to Senator Coonan and have had a meeting with Tony Coles, Manager Superannuation, Retirement & Savings – Treasury.

I am writing to you to relay some of the comments by our clients to the recent changes and the concern and dismay they feel over the legislative changes.

A number of clients have expressed the concern that their superannuation pensions (apart from allocated pensions) will now be forced to be provided by institutions only. Generally, our clients have established their DIY funds with the view that they have a say in the assets that they purchase, when and how they are purchased and how those assets are used to provide income streams, for them in their retirement, assets to support their spouse in their demise and the residual amount to pass to their children. These changes take away the very things that give people the comfort to use superannuation as an entity. DIY funds are established by clients predominantly because they wish to be involved in the provision of their own future, by selecting the assets they wish to have and how and when it is paid to them and their estates.

Many of our clients, through their superannuation funds, structure their funds with the following in mind:

1. A portion of there funds in a lifetime pension to provide for them and their spouse in retirement
2. A portion in residual capital value (or term certain) pension to live off the earnings of the assets and have an asset which on death they can pass as a lump sum to their children, and

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3. A portion in allocated pensions to provide the flexibility of income to adapt to the changing needs from year to year.

All three pensions being run together through one fund, the DIY, simply and efficiently.

The DIY fund provides a natural balance for people to choose their assets, provide for their retirement, provide for their spouse after their passing and leave something for the next generation.

This change has removed their ability to do this except where the client is happy not to have a say in the investments and on their death accept that there will be no assets to pass to the next generation. Moreover the residual amount will go to providing for everyone else, not their children, given that the assets will be retained by the institution on their passing or their and their spouses passing. Further to this, for a client to move to using a institutional pension they will be required to sell assets which may have substantial capital gains to purchase the annuity. This would not be required if the pension was run from the DIY itself. This is seen as an impediment to commencing pensions and a significant disadvantage to the financial position of the member.

Additionally, clients have significant concerns about the charges, entry fees, earnings crediting rates the institutions charges and levies. Many clients have expressed the desire to reduce the amount they put into super as a result as they are not willing to give the assets to the institution. This seems to be a logical conclusion to our clients. After all, the reason most people establish DIY funds is the ability to have control over the assets they purchase; it is their hard earned money. This clearly is reflected in the reported statistic that 50% of all net superannuation money last year went to DIY funds.

I note from commentary in various articles and discussions with other professionals that there is a perception some funds have been using the various pensions to avoid RBL limits. It should be noted that the mere effect of removing the ability for a small fund to run the pension does not change that ability to avoid, it simply means that in order to do the same you will need to use a pension provided by a life company. To that extent those people who are doing this are likely to continue to do so through that source and the balance that were not doing so have been left disadvantaged.

From an RBL point of view, I have always been amazed that in most situations $1.00 of taxed element of the fund equals $1.00 of RBL, yet when using any form of defined benefit pension (lifetime or term certain RCV pension) we are required to use a capital value formula creating a different result. It is the formula which creates anomalies in RBL not the small fund. Perhaps a more prudent approach be to simply make each taxed element dollar equate to a RBL dollar. This would be far more preferable than removing the ability to have the pension itself and taking away that ability for people to provide for their retirement, their spouse and their children.

As a firm we suggest to our clients that if they take a lifetime pension they separate out the undeducted portion from the taxed element and run separate pensions. This way it can never be construed that a pension was commenced for any RBL reason. In fact we often use pensions which create reportable RBL, again an anomaly of the capital value calculation. For example a $500,000, 100% residual capital value pension, with 100% undeducted money for a 65 year old male reports an RBL value of $197,864, even though it is all undeducted money.

Perhaps an approach which alters the legislation to provide comfort and practicality to the areas of concern would be more appropriate than removing the ability for people to provide for their families with their own assets.

I certainly recognise the need to ensure that fraud is properly dealt with, but if we sit back and ask ourself if the consumer actually benefited from these changes then the answer is clearly not. Unfortunately the many have been disadvantages as a result of the actions of a few. If the actions of the few can be curtailed by other means whilst not disadvantaging the many, perhaps we will all end up with a better superannuation system.

It would seem that solutions which deal with the concerns and yet do not reduce the flexibility of type of pensions could be implemented which provide solutions to areas of concern for the government as well as continue the flexibility to those that use the legislation the way it was intended.

I propose that consideration be given to other solutions to maintain integrity of superannuation system yet allow flexibility to pension types.

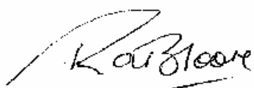
- Removal of capital value formula, having taxed amounts assessed for RBL purposes
- Vest all money to a member ie no contribution reserves
- Options for Growth pensions (both *non commutable* and *commutable*)
- Introduce a term certain, residual capital value commutable market linked pension to compensate for the loss of defined benefit commutable pensions (ie SIS 1.06 (6) pensions)
- How to facilitate lifetime style pensions

The term certain pensions (including Residual Capital Value pensions) could be required calculated using a defined table based on the solvency factors rather than the 70% high degree probability factors (as these pensions come under the lump sum RBL not the pension RBL) therefore more closely ensuring that amounts are paid out rather than end up in the reserve account. Should the pension not be able to meet the solvency test the pension should be reduced accordingly (as currently is required by the SIS regulations). As this, again, is a lump sum RBL tested issue this would be no real difference to the effect available to allocated pensions and market linked pensions whose payments are reflective of the value of the fund at the beginning of each year, yet deal with the issues relating to consistency of payments (unlike allocated pensions).

Attached is a copy of the summary I left with Tony Coles as a result of our meeting with Treasury for you to review.

I would be happy to meet to further discuss this matter should you feel it appropriate.

Yours sincerely
Smartsuper Pty Limited



Andrew Bloore
Managing Director

Summary of matters for discussion

1. Recognition that there has been and will continue to be people who are not using superannuation in the spirit in which it is intended. Those issues go to the general integrity of the superannuation model and include items such as:

   - Capital Value formula allows for manipulation of RBL (positively and negatively)
   - Centrelink effects of the capital value formula
   - Common strategy for Defined Benefit DIY funds - keeping amounts in the contribution reserve to defer or avoid surcharge
   - Use of reserve accounts through accumulation phase of a DIY Fund

2. New legislation allows for the rorts to continue for those who choose to rort the system and penalises those that are legitimately using the pension structures.

3. Why people use DIY funds (including SMSF's and SAF's) and the motivators behind the funds establishment.

   - Increasing trend to move away from institutions due to level of fees, poor performance (both perceived and real), lack of control, lack of choice in investments

4. Concern over the presumption that life companies are more capable of looking after people's assets than themselves

5. The manner in which people use the various pensions to suit their circumstances

   - Various pensions and how they are currently used (legitimately)
   - General knowledge of superannuation administrators on pensions

6. Considerations to other solutions to maintain integrity of superannuation system yet allow flexibility to pension types.

   - Removal of capital value formula, having taxed amounts assessed for RBL purposes
   - Vest all money to a member ie no contribution reserves
   - Options for Growth pensions (both non commutable and commutable)
   - Introduce a term certain, residual capital value commutable market linked pension to compensate for the loss of defined benefit commutable pensions (ie SIS 1.06 (6) pensions)
   - How to facilitate lifetime style pensions

7. Grandfathering rules clarification to assist with clients who are forced/wish to commence pensions now but cannot or will be above the lump sum RBL with no real options for complying or term certain pensions.

8. Senate Select Committee possibility of formal presentation