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# Self Managed Superannuation Funds: Some Public Policy Issues Regarding their "Decumulation" Phase

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The author of this paper is Assoc Professor Owen Covick of the Flinders Business School, Flinders University and also Research Associate of the South Australian Centre for Economic Studies.

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# Self Managed Superannuation Funds: Some Public Policy Issues Regarding Their "Decumulation" Phase

## Overview

This paper argues that the 2006/07 package of superannuation reforms, together with certain pre-existing factors with which those reforms have interacted, will:

- encourage a greater quantum of Australian household sector wealth to be held within the nation's superannuation system;
- encourage a greater proportion of the nation's superannuation system assets to be held in vehicles enjoying *decumulation* phase superannuation tax-treatment; and
- encourage a shift within the range of available *decumulation* phase vehicles, in favour of those which have become known by the title "allocated pensions".

Combined with the current degree of popularity for the self-management of super these factors will lead to a substantial growth in the overall quantum of monies in *decumulation* phase SMSFs in Australia, and in the volume of paperwork required to be managed by the trustees of those funds.

The paper then raises the question: What if the ageing process, or the death of the "prime mover" member of a more-than-one-member *decumulation* phase SMSF allows such an SMSF to "drift on", past the point at which it would have been in the best interests of the vehicle's members to wind it up and either rollover into an APRA-regulated vehicle, or take the remaining funds outside the superannuation system?

The paper argues that this should be viewed: (a) as a public policy issue and not simply as a problem for the individual SMSF members directly concerned; and (b) as a public policy issue that should be tackled now, rather than simply wait for the numbers of persons directly affected by the problem to swell to significant proportions.

The paper concludes by making three suggestions for ways of addressing this problem.

## Introduction

Self Managed Superannuation Funds (SMSFs) have experienced a dramatic growth in popularity in Australia over recent years. In 1995 there were around 97,000 SMSFs. In 1999 there were 187,000. By December 2007 there were over 368,000 SMSFs, with a total of over 700,000 members.[1]

The majority of these Self Managed Superannuation Funds are in their *accumulation* phase, meaning they have not commenced the process of being drawn-down to support the income needs of members who have retired from the workforce (or who are taking advantage of "transition to retirement" arrangements). But already there are a substantial number of SMSFs in the *decumulation* phase, in which their investment income is subject to a zero rate of tax. And the number of SMSFs in the *decumulation* phase can be expected to grow as the current members of SMSFs grow older, unless significant numbers of those persons make the choice to shift out of self-managing their superannuation monies.

Whilst public policy debate on superannuation in Australia has been more focussed on *accumulation* phase arrangements than *decumulation* phase arrangements, the two must be recognised as representing parts of the one overall framework. This paper argues that in respect of the *decumulation* phase of SMSFs there are some perplexing public policy issues which, if left unchecked, will grow in magnitude as successive cohorts of SMSF members pass retirement age, and move successively deeper into the *decumulation* stage re. their superannuation savings. The paper argues that it would be useful to commence worrying about appropriate regulatory arrangements for managing these processes sooner rather than later.

Firstly however, it is important to spell-out how the operations of an SMSF in its *decumulation* phase are typically structured. For the great bulk of *decumulation* phase SMSFs this takes the form of what most Australians have become accustomed to call an *allocated pension*. The Commonwealth Government *Simplified Superannuation* package that took effect in mid 2007 contained features that have significantly increased the attractiveness of *allocated pensions* for many middle-income Australians over the age of 60. This has interacted with the growing popularity for the self-management of superannuation funds across significant segments of the Australian community to pave the way for an expansion in what might be termed *self-managed allocated pension funds* in Australia.

## What is an Allocated Pension?

In everyday language, the word "pension" in the context of a discussion of retirement income arrangements usually connotes a regular income stream that continues at some stable and predictable level until the pensioner dies (or chooses to "commute", if the contract so permits).

*Allocated pensions* do not have these characteristics. One way of understanding what allocated pensions are, and how it is that the word "pension" appears in their title is to commence by noting the relationship between a traditional whole-of-life life-insurance policy and a traditional life-annuity. Essentially the one is the mirror image of the other. In the traditional whole-of-life life-insurance policy the insured contracts to make a series of regular payments of a pre-determined size, to the insurer, commencing from the date of entering the contract and ending at the point of the insured's death. In return, the insurer contracts to make a single lump-sum payment of a pre-determined size to the insured at the point of the insured's death. In the traditional life-annuity the insured contracts to make a single lump-sum payment of a pre-determined size to the insurer at the date of entering the contract. And in return, the insurer contracts to make a series of regular payments of a pre-determined size to the insured, commencing from the date of entering the contract and ending at the point of the insured's death.

Looking at these two products, the traditional whole-of-life insurance policy and the traditional life-annuity, it can be seen that in both cases the product that the "insurer" enterprise is providing is a bundling-together of two services: a funds management service and a *true* insurance service. In both cases, in *ex post* terms, the insured who lives exactly the actuarially predicted life-span might be thought of as essentially receiving the funds management service only. In the whole-of-life policy case there is management of a regular and equal instalments accumulation, which plus a promised earnings rate and minus set charges for administration etc., is returned to the client at "maturity". In the life annuity case, it is management of a regular and equal instalments decumulation with otherwise equivalent features in terms of the client receiving a return to them of their own funds plus promised earnings rate minus set charges for administration etc.

Now imagine a client who wants an accumulation funds-management service for a period of some years but who does *not* want this bundled with a life-cover insurance service, and who moreover wants a flow-through to themselves of the earnings-rate on their funds under management (instead of a promised rate) together with flexibility regarding the size of the periodic instalment payments they make into the accumulation. For a funds-management enterprise to make available a product that caters to these tastes is simply evidence of the market mechanism at work. But for the resulting product to be described as an "insurance policy" would seem to involve a highly "imaginative" stretching the usage of those words. Be that as it may, for many years now Australia life insurance enterprises have been marketing as "life insurance policies" contractual arrangements which involve zero life cover, full flow-through exposure to the earnings on the funds-under-management, and the flexibility to make any number of "single premium" payments of varying sizes and at times of the client's choosing. And accumulation wealth-management vehicles of this type (together with their direct equivalents offered by entities other than life offices) have traditionally enjoyed access to the income tax preferences accorded to "superannuation" in Australia, provided they comply with the various other requirements that have been in place (and subject to evolution) over the years, including preservation, "no gearing", the employment status of the client etc.

An "allocated pension" can be defined in the broad sense as the name that has come into use in Australia since the early 1990s to describe decumulation wealth-management vehicles which stand in the same relationship to the traditional life annuity as the "flexible" accumulation wealth-management vehicles discussed in the previous paragraph stand to the traditional whole-of-life life insurance policy. In other words, if you take a traditional life-annuity and (a) strip out of it any "life" insurance (or longevity insurance); (b) provide full flow-through exposure to the earnings rate on the funds-under-management; and (c) provide for flexibility in the size of drawdown payments made to the client during the decumulation period, what you are left with is an "allocated pension" in the *broad* sense of that term's use in Australia. For the *narrower* sense, it is necessary that the product in question qualifies for the income tax preferences accorded to superannuation pensions/superannuation annuities in Australia.

## Taxation in the Decumulation Phase

Until the 1988-89 round of superannuation reforms in Australia, there was no particular need to distinguish for taxation purposes whether the monies held in a particular superannuation scheme were standing behind that scheme's responsibilities towards members who had started to receive pension drawdown payments, as distinct from monies standing behind the scheme's responsibilities towards members still in the *accumulation phase* (whether in the status of contributory members or of non-contributory members who had not yet commenced drawdown). Either way, the investment earnings on those monies were income tax-free in the hands of the fund, provided the scheme met the various requirements for the tax preferences accorded to superannuation. And the annuity or pension payments received by decumulation-phase scheme members were subject to standard personal income-tax treatment in their hands, except for the tax-free un-deducted purchase price element. Thus, prior to the 1988-89 round of superannuation reforms, the Australian system for the taxation of superannuation was essentially one focussed on taxation at the receipt-of-end-benefits stage. Exemption from tax at the contribution stage and exemption from tax during the earnings stage was succeeded by a taxing-point at the pay-out stage, either via the superannuation lump-sum scale (introduced in 1983, but subject to a grandfathering of the preceding more lenient tax-treatment of lump sums) or via the "normal personal scale" for pension/annuity receipts. This was the 'norm' except where contributions-monies had already passed through an income-taxing point which had not been reversed (or "deducted"). For these dollars there was tax-exemption when they reached the pay-out stage.

The decision announced in the 1988 Budget to *bring-forward* fifteen percentage points of superannuation taxation to the contribution and fund-earnings stages of the superannuation cycle meant that it was viewed as no longer reasonable for the distinction between investment earnings on fund-holdings re accumulation-phase members and investment earnings on fund-holdings re decumulation-phase members to be simply ignored. The upshot was that the fifteen per cent fund-earnings tax was restricted in its operation to earnings on fund-holdings attributable to commitments to accumulation-phase members. Earnings on fund-holdings standing behind commitments to complying pensions and complying annuities that were actually being paid were to continue to be tax-free.

For the first few years of the post-1988 Australian superannuation system the status "complying" as used in the last sentence was restricted to pensions/annuities that embodied the traditional longevity insurance feature that in normal usage is associated with the word "pension" (i.e., the payment stream would continue to flow until the "pensioner" died - even if this was at a date substantially later than the life-tables had forecast). This, together with the fifteen percentage points income tax rebate on income from complying superannuation pensions/annuities, and the two-tier RBL system, would seem to suggest that policy-makers were seeking to encourage citizens to take their superannuation end-benefits in ways which constrained the early dissipation of accumulated principal and locked-in prudently-managed longevity-insurance cover. Looking at superannuation arrangements from a public-policy perspective, these two factors of constraining premature dissipation of tax-advantaged accumulation of principal, and rewarding the locking-in of longevity-insurance cover can be viewed as representing appropriate *quid pro quo* to be borne by the direct beneficiaries of the superannuation system's tax-preferences, with a view to reducing the probabilities of those same persons needing further significant transfusions of resources from the remainder of the community's taxpayer base during their retirement years.

A third factor of public-policy significance should also be noted at this point. This relates to the consequences for the remainder of the community's taxpayer base if the direct beneficiaries of the superannuation system's tax-preferences seek, instead of consuming the benefits of these tax preferences directly themselves, to pass them on to their heirs. Perhaps this is only truly a public policy issue where the process is accompanied by significant cost shifting of the retired person's living costs etc., to the community taxpayer base? Otherwise, why would one want to press a person to consume themselves what their own sense of altruism tells them is best transferred to be consumed by another? This "third issue" of public policy will be revisited below.

Focussing back onto *allocated pensions* and their essential properties as outlined above, it would now seem reasonable to raise the question: If that is what an "Allocated Pension" is, why was the taxation status of wealth-management vehicles embodying those key properties so substantially enhanced during the John Dawkins round of superannuation taxation reforms of 1992-1993? There are probably two main ways in which that question might be approached. The first would be to argue as follows. (a) A set of superannuation arrangements is a means of dealing with a human-life-cycle-phenomenon. (b) This means there is typically a period in which income is earned by the individual from the supply of labour services, followed by a period in which the individual no longer earns income from the supply of labour services. (c) Public policy should encourage each individual to save/accumulate during the first part of the cycle in order to cover their personal outgoings during the second part of the cycle. (d) Such types of arrangements as have been condoned/encouraged by public policy for the accumulation phase should be regarded as equally merit-worthy of equivalent treatment for the decumulation phase. (e) Therefore, if policy-makers have been satisfied to accept an extremely *laissez faire* approach re the accumulation phase, why should they not be satisfied to accept an equivalent *laissez faire* approach for the decumulation phase? (f) Hence: give decumulation-phase arrangements that are more "flexible" than traditional life annuities/ pensions the same treatment as traditional life annuities/pensions as long as these arrangements bear the same type of relationship to traditional life annuities/pensions as the accumulation phase arrangements we condone/encourage bear to traditional whole-of-life life insurance policies.

The second approach can be represented in "sequence of logic" terms much more simply. It would read: (a) you (i.e., public policy makers) want retirees to take their superannuation benefits in the form of income-streams rather than in lump-sums. (b) this is not happening - despite the introduction of lump sum taxation in 1983, the 15 per cent rebate, the two tier RBL scale etc. (c) why not therefore give some defined sort of "flexible" income stream products the same taxation treatment currently reserved for complying annuities/pensions? This is bound to entice at least some retirees away from the lump sum option towards the "income stream" approach.

At the time that John Dawkins was Commonwealth Treasurer, the Australian Government was pressed with both these strands of argument. The 1992-93 reforms to Australia's superannuation system contained significant modifications to the policy-framework re flexible income-stream products for the drawing-down of super fund monies. The Dawkins package can be viewed as providing an authorised "corridor" for superannuation decumulation contract arrangements. Where a decumulation contract provided for a pattern of draw-downs that were always to be beneath the "ceiling" time-path prescribed, but always to be above the "floor" time-path prescribed, the taxation treatment applied to the earnings on the investment funds supporting the contract would be the same as that applying where a longevity-insurance providing pension was being provided. But without longevity-insurance, such a contract would not qualify as a complying annuity/pension for RBL purposes.

The metaphor of an authorised "corridor" makes this system sound far simpler than it was. For year one of such a contract, there would exist a well defined permissible drawdown range. This range can be thought of as being centred around the payment which a prudent fixed-term annuity provider would pay to a client handing over a given lump sum of funds for a fixed term annuity with a term coinciding with the client's life-expectancy. But at the end of year one, the location of the corridor would be redefined so that at that point its centre would reflect the payment which a prudent fixed-term annuity provider would pay to a new client handing over the now-existing funds standing against the client's name (affected by the year one earnings rate and the year one drawdown quantum) for a fixed term annuity with a term coinciding with the life expectancy of a client who was one year older. Note here that where a person ages by a year (and thus "survives" through a year) their life expectancy diminishes by less than one year. Thus the picture of a well-defined corridor stretching out through the future life-time of the person signing up for this type of contract was an illusion. The bounds of the corridor would only be well defined one year forward and would shift year-by-year. This system proved popular among large numbers of Australian retirees but "simplicity" is unlikely to have been its most powerful selling point - unless the take-up has been concentrated among persons who have not inquired further when presented with the graphics showing a well-defined corridor stretching out through to their "twilight years".

During the most recent three years or so, the allocated pensions market has been given a further boost stemming from the Howard government's adoption of a more lenient and flexible approach to the distinction between the accumulation phase of an individual's participation in the superannuation system and the decumulation phase of that individual's participation. Older Australian workers may now be quite open about having some of their superannuation savings in a decumulation vehicle, with the earnings on those monies tax-free in the hands of the fund, whilst at the same time accessing taxation preferences associated with having further flows of superannuation contributions going into accumulation vehicles (where, however, the fund-earnings are subject to tax at the 15 per cent rate). Previously, to achieve this situation it was necessary to have at some stage "retired from employment", and then subsequently (after some appropriate period) declared a change of mind.

**"Simplified Superannuation" and Allocated Pensions**

Under the superannuation reform package announced by Treasurer Costello in May 2006, three matters in particular would seem highly likely to further enhance the popularity of allocated pensions as a class of wealth-management vehicle for Australians. Firstly, there is the change in the tax-treatment of superannuation end-benefit payments received by decumulation-phase fund members over the age of 60. Secondly there is the ending of the RBL system, and with it the relative attractions that system provided to those with large stakes in the super system to opt for longevity-insurance-providing-products as distinct from pay-out arrangements without longevity insurance. Thirdly there is the removal of the "authorised corridor" requirements on allocated pension arrangements and its replacement with a "no ceiling" and "much simplified floor" approach. Each of these three will now be examined in turn.

Since 1 July 2007, the 15 percentage points of superannuation taxation which were "brought forward" in the 1988 Keating package have remained in place, but those elements of superannuation taxation which the 1988 package left at the receipt-of-end-benefits stage are abolished where the recipient fund member is 60 years of age or above. This can be expected to serve as an incentive for those at or above 60 to shift their superannuation savings from being subject to accumulation phase tax treatment to become subject to decumulation phase treatment. Under the latter there is zero tax on fund investment earnings in the hands of the fund, and zero tax of the payout monies in the hands of the recipient. If the person's preferences are against dissipating the payout monies, these can be paid back into an accumulation-phase superannuation-fund holding. If the individual's personal income tax position is such that their marginal tax rate is above 15 per cent, it may be in their interests to channel this repayment so as to be a deductible contribution. Otherwise it can be a non-deductible contribution, and free from the 15 per cent contribution-stage tax upon its (re)entry into the system. While any such re-contributed monies remain as accumulation-phase superannuation funds, the investment-earnings on them will be subject to 15 per cent tax. But at some appropriate point down the track that 15 per cent can be eliminated by the triggering of a new allocated pension.

Much of the media commentary on the Simplified Superannuation package was focussed on the new rules for limiting how much of their money each Australian can contribute into the overall superannuation system. No doubt many observers will have seen a certain irony in it becoming a public policy concern to hold the gates closed to stem the tide coming in, rather than trying to hold back the tide pressing to get out. But there appears to have been far less popular attention paid to the distinction between the two types of money that sit inside the walls of the superannuation system: accumulation-phase money and decumulation-phase money. Once you've passed your 60th birthday, a dollar of the latter is likely to be more valuable to you than a dollar of the former. And to convert from one to the other you basically just need to trigger an allocated pension. Even among those between 55 and 60, the conversion of funds from accumulation to decumulation phase may be to an individual's advantage, depending on the arithmetic of any available re-contribution strategies under that individual's circumstances.

Under the Reasonable Benefit Limits (RBLs) system that was abolished under the Simplified Superannuation package, holders of more substantial balances of funds within the superannuation system faced tax advantages in taking at least half of their end-benefits in the form of income-streams that "complied" with a defined set of requirements. Those requirements were designed essentially to minimise the risk faced by the income-stream recipient that their income-stream would "dry-up" in value at some point prior to their death, either because of greater-than-anticipated longevity or through lesser-than-anticipated investment returns on the funds monies supporting the payment streams.

At least some of those Australians who under the RBL system opted to take half of their end-benefits in complying pensions/annuities of this type may have chosen thus on the grounds of the RBL tax penalties associated with choosing otherwise. It would appear that many Australians would prefer to shoulder the risks associated with the more "flexible" allocated pension products than pay the *actuarially fair* price that is associated with a prudently-managed commercial pension provider accepting to take over those risks. Alternatively it might be that they see it as preferable that any "benefits" from shorter-than-anticipated longevity and/or better-than-expected investment returns should go to their heirs while any costs from longer than anticipated longevity and/or lower than expected investment returns should be borne by the remainder of the community through the tax-and-transfers system.

The removal of the "authorised corridor" requirement for allocated pensions, as well as greatly simplifying the functioning of these vehicles, effectively removes most of the last vestiges of similarity between them and any arrangement that could reasonably be regarded as warranting the nomenclature of "pension" or "annuity". The elimination of any "ceiling" on the amount per period that can be paid out (together with the tax free status of the pay-out in the hands of the allocated pension holder) removes any constraint on rapid run-down/early dissipation of the funds.

The continuation of lower limit requirements for each year's total payouts from an allocated pension allows the vehicles to be described as belonging to the decumulation class of superannuation vehicles, but for the younger of the fund members the floor pay-out rates required are set very low and could be affectively backwardised via a suitable re-contribution strategy. The bottom-line is that the "allocated pension" has become yet more flexible as a vehicle for obtaining tax-advantaged income tax treatment on a portion of one's wealth-holdings. And that at the same time as the dimension of those tax advantages has been substantially enhanced for all but those with very low personal taxable income. Only for the over 75s is the "requirement" to decumulate year-by-year asset holdings in the tax advantaged superannuation environment more than a mere formality.

## Self-Managed Allocated Pensions and Public Policy

It has been argued above that the 2006-07 package of superannuation reforms (together with certain pre-existing factors with which those reforms have interacted) will encourage a greater quantum of Australian household sector wealth to be held within the nation's superannuation system, will encourage a greater proportion of the nation's superannuation system assets to be held in vehicles enjoying decumulation-phase superannuation tax-treatment, and will encourage a shift within the range of available decumulation-phase vehicles, in favour of those which have become known by the title "allocated pensions". Nothing has been said so far to argue that policy-changes in the 2006-07 package mean that self-management has been rendered more attractive relative to holding one's superannuation monies through APRA-regulated superannuation funds. And it is not the intention of this paper to seek to mount such an argument. Rather, it is proposed that the three sets of processes summarised above, together with self-management of super merely maintaining its present degree of relative popularity among the Australian community, will lead to a substantial growth in the number of self-managed allocated pensions in Australia and in the volume of self-managed allocated pension paperwork requiring to be managed by the fund trustees, and in the volume of paperwork requiring to be lodged with the relevant regulator, the ATO. The *Simplified Superannuation* package increases the regulatory levy on SMSF's from $45 to $150 per year, and imposes a requirement that a "trustee Declaration" be signed and lodged with the ATO by all new trustees appointed after 30 June 2007. While those measures might serve to provide some element of discouragement to self-management, the package simultaneously promises to streamline reporting requirements from three forms to one for post-July 2008 reporting.

Most of the media discussion of the pros and cons of self-managing either some or all of one's superannuation in Australia seems to take place with a focus on the accumulation-phase context. And that discussion appears to boil-down to two strands: one focuses on the explicit pecuniary costs, cost-savings and benefits associated with the self-management mode as compared with leaving things at arm's length with one or more APRA-regulated fund; the second focuses on the non-pecuniary or "psychic" benefits and costs of bearing responsibility for various decision-making, record-keeping and compliance tasks inside the family-unit, as compared with having these pleasures and displeasures borne by "strangers" (and subject to *principal-agent* issues). Two messages appear to come across from this discussion. Firstly, there is some minimum effective scale for an SMSF. Although there is a divergence of views as to what the dollar figure of this is, and it varies with the productivity (and opportunity costs) of the fund members(s)' own labour that is applied to the self-management tasks, it is unanimously accepted that below some figure for the value of assets in the fund, self-management is a recipe for burning up resources. ASIC, through its FIDO website, suggests an assets-level of $200,000 for an SMSF to be "competitive" in cost terms with a low cost professionally-managed fund. It should be noted that according to ATO data, approximately 30 per cent of SMSFs have less than $200,000 in assets. An ATO survey indicated that for SMSFs with assets less than $50,000, operating expenses averaged 10.51 per cent of total assets.[2] Secondly, there is a need for at least one of the four or less members of the SMSF to have sufficient enthusiasm and disciplined self-application to ensure that the trusteeship duties are fulfilled on a regular basis and appropriately documented as thus.

When it comes to making a decision to set up an accumulation-phase SMSF, the person(s) responsible for taking that decision will usually be able to take comfort from two things, when mulling over the two "messages" described above. An accumulation-phase SMSF, by definition, should rise in the value of its asset-holdings over time (even if not monotonically). Hence if scale-viability is "borderline" at the outset, but not substantially worse than borderline, this might be expected to be self-correcting over time. Secondly, with an accumulation-phase SMSF, the 'prime-mover' self-manager is likely to be a person "in the prime of life" who might be able to feel confident that if their skills and aptitudes for the trusteeship tasks required are "borderline", these might be expected to improve after a few years of "learning by doing".

These two sources of comfort might be available to persons in their 50s or 60s contemplating establishing self-managed allocated pensions, provided they restrict their thinking to a relatively short future time-horizon. Objectively, it might seem reasonable to expect such persons to appreciate that: (a) a decumulation-phase superannuation fund will at some stage start to shrink in size and will at some stage (if its members do not die first) fall below whatever the appropriate benchmark then is for scale-viability; and (b) the processes of ageing and mortality among the fund-members might at some stage render the trusteeship tasks onerous for the surviving fund-member(s), but this might occur in a manner that makes it difficult for the self-manager to accept that this is the case until the trusteeship duties have already been neglected for a period. Whilst *objectively* it might seem reasonable to expect that some heed be given to these two considerations, *realistically* it might be more appropriate to envisage that process more often than not concluding with the individual promising themself (and their spouse?) that these considerations will be properly re-visited "in the fullness of time" when they are no longer matters at such a great distance from the more tangible here and now.

The removal of the "ceiling" restriction re drawdowns under allocated pension arrangements may serve as an encouragement to the establishment of self-managed allocated pensions by persons in their 50s and 60s who promise themselves that they will reconsider the longer-term future of their vehicle when that longer-term future is no longer so far away. Without the ceiling restriction, the process of implementing an exit from such a vehicle, at a time when it is judged appropriate to do so, is rendered more simple. So why worry about that right now?

But there is a potential problem. What if the ageing process, or the death of the "prime-mover" member of a more-than-one-member self-managed allocated pension allows that self-managed allocated pension to drift past the point at which it would have been in the best interests of the vehicles members to wind it up and either rollover into an APRA regulated vehicle, or take the remaining funds outside the superannuation system? What might appear at first sight to be a problem simply of the members of such a vehicle might easily become a growing headache for the regulator of such vehicles, and for public policy. If the regulator starts to receive increasing numbers of annual returns from self-managed allocated pensions that are clearly well below any reasonable threshold for a viable scale and/or finds that increasing numbers of self-managed allocated pensions of small size are falling further and further behind with their paperwork, what is the regulator expected to do? In the latter case doing nothing might have some attractions as compared with the alternative of employing increasing volumes of regulatory resources to impose increased anxiety burdens on elderly persons who may already be in fairly vulnerable states.

The argument of this paper is that it would be wise from a public policy perspective to do something now about the framework for handling this potential problem, rather than wait for the numbers of persons affected by the problem to swell to significant proportions.

Here are some suggestions for ways of addressing the problem:

(1) Define a minimum size of fund holdings for a "viable" self-managed allocated pension (subject to appropriate annual indexation). Do not permit a vehicle to be established if it is not above that figure. Require either rollover into an approved APRA-regulated vehicle or removal of the funds from the superannuation system within a specified period of a vehicle's decumulating below that figure.

(2) Where a trustee of an SMSF is older that some defined age (say 75?), require that a signed Trustee declaration form be lodged annually *and* require that it be supported by a signed statement from a medical practitioner certifying that it is compatible with the person's health status that they continue to shoulder the duties/responsibilities of trusteeship.

(3) Require that the trust deed of each self-managed allocated pension contain clauses providing for an orderly winding-up of the vehicle, under the supervision of a defined outside party, under some specified "triggering circumstances". The idea is essentially that just as each APRA-regulated superannuation fund is required to designate an ERF to take-over management of the funds of a member where those funds are so meagre at to be in danger of turning to dust, an equivalent mechanism should be mandatory for SMSFs so small as to be in the process of turning to dust. Once such a mechanism was in place to deal with that contingency, it could be given additional triggers such as when the trustee has been unable to obtain a medical practitioner's certificate of the type described in (2), and/or when a vehicle's annual returns obligations have fallen some defined period in areas and after specified reminder processes and time-extensions etc., have been exhausted.

# End Notes

[1] Figures quoted in Senator Sherry's Media Release No. 013, dated 12 March 2008.

[2] Figures quoted in: Senator Sherry's address to the SMSF Professionals Association of Australia (SPAA) Conference, 12 March 2008.