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RETIREMENT SOLUTIONS ACTUARIES

TECHNICAL NOTE: NON-PERFORMING CENTRELINK PENSIONS

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1. THE PURPOSE OF THIS TECHNICAL NOTE

The global financial crisis and resultant sharp drops in asset values mean a number of SMSFs find themselves with “non-performing” pensions. Centrelink defines a non-performing pension as one that does not have a positive opinion of adequacy on a high probability basis. The consequences can be severe, but interim Ministerial relief measures may be of assistance.

The purpose of this Technical Note is to examine the consequences of a pension going non-performing for Centrelink Age Pension purposes and the remedial steps that can be taken.

2. BACKGROUND INFORMATION

Until 19 September 2004 a 100% ATE income stream for means test purposes was available in a SMSF by either a SIS Act s1.06(2) lifetime (called Section 9A lifetime income stream under the Social Security Act 1991) or s1.06(7) life expectancy income streams (called a Section 9B life expectancy income stream under the Social Security Act 1991). After that date, a 50% ATE could be obtained from either these income streams or with a Section 1.06(8) market linked account based income stream (called a Section 9AB income stream). SMSF were banned from offering new defined pensions from 01/01/2006. From 20 September, 2007 no new income streams from a SMSF will attract any ATE benefit. Limited options still remain to commute and rollover ATE pensions that retain some or all ATE status. This will be detailed later in this note.



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A defined lifetime pension is an unallocated design while a market linked pension is an allocated account based pension. Both are complying pensions. With a defined pension, the member exchanges an accumulation balance for a specific promised income stream. The accumulation balance is transferred to the trustees who may pool it with other reserves. The defined pensioner then has no call upon any account and does not share in any gains or losses made by those assets. They own a defined income stream, not an account.

Unless a SMSF purchases an annuity to back its defined pension, actuarial certificates are required. At commencement, each lifetime or life expectancy asset test exempt income stream must have its own actuarial certificate. After that, a single certificate with separate statements will suffice. The certificate must have the positive opinion that APRA MD23 high probability condition is met. For the positive opinion, a maximum in force period of 12 months applies. There is a 26 week grace period allowed for a new actuarial certificate to be provided. After that a pension loses its ATE (Asset Test Exempt) status – and could be assessed as never having been ATE with a large debt being raised for a 5 year look back period.

3. LOSS OF A POSITIVE OPINION CONSEQUENCES

Where an actuarial certificate is issued that does not provide a positive opinion, the income stream will retain ATE status for a further 12 weeks from the date of issue of the certificate to allow time to:

- ◆ commute the income stream and roll-over to a new ATE income stream;
or
- ◆ in the case of an error or mistake, to allow the customer to provide a new actuarial certificate which specifies a valid high probability/positive opinion.

If no action is taken, the income stream will lose its ATE status and become assets tested at the end of the 12 week grace period. The customer will be assessed as if the income stream never had ATE status from commencement and this may result in a debt being raised via a prior 5 year re-assessment.



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4. CAN A POSITIVE OPINION BE REACHED?

SMSFs often have considerable property holdings. These should be checked to ensure they have been re-valued to market prices. This may solve the inadequacy problem. Also, the valuation date could be updated if the share values have improved. Where there are account based benefits, a lower crediting rate would leave more in the unallocated portion of the fund backing the defined pension. There may be discretionary increases that can be reduced. Finally, check that the investment strategy has been appropriately specified and not too conservatively set – more assets intended for higher, longer term growth means less capital required to back the pension. By way of example, the whole fund may be in cash at the moment – but the long term strategy may be to follow a balanced strategy. There is a separate “Tech Note” Inadequate Defined Pension Assets” that considers this issue in more detail.

5. ROLLOVER AND RETENTION OF ATE STATUS

Social Security Guide 4.9.2.17 explains the relief granted to certain ATE lifetime, life expectancy or market linked income streams purchased from 20th September, 2007 from the commutation of an ATE income stream purchased prior to 20th September, 2007. To retain 100% or 50% exemption, the original income stream must satisfy the primary conditions for relief as well as one of the additional sets of conditions. A pre 20 September 2004 income stream will need to move to a life office annuity (defined pensions no longer available for SMSF) to retain 100% ATE.

Post 20 September 2004 ATE income stream can be moved to a market linked pension with the SMSF or externally to a life office annuity.

The primary conditions deal with original ATE eligibility. The additional sets of conditions deal with death, hardship, surcharge debts, divorce etc. The one of interest is Centrelink Note Condition 3 for lifetime and life expectancy income streams that do not satisfy the high probability requirements. In these circumstances a roll-over that retains ATE may be possible. In other contexts, Centrelink Note Condition 11 allows a once only option where the administrative responsibilities of the fund supporting the original income stream have become too onerous due to the age or incapacity of a trustee.



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6. INTERIM MINISTERIAL RELIEF AVAILABLE

Earlier relief allowed defined pensions that were non performing to continue in 2009/10 in the hope that they would become adequate again, but at the cost of the permanent loss of the ATE. The concession was that the debt from a 5 year look back reassessment period was waived.

This relief is now rather irrelevant because on 31 August 2009 the Minister extended this waiver of debt relief to the situation where the defined pension was converted to a market linked pension. The choice now is whether it is likely that the pension will be adequate in the six month period to provide a positive statement (or in the subsequent 12 week grace period). If this is not likely, then a rollover to a life office annuity with ATE exemption or a market linked conversion needs to be seriously considered.

The waiver of debt relief is only available until 30 June 2010. The conversion to a market linked pension means the ATE is permanently lost. Only non performing pensions have this option. It is assumed that pensions that meet the high probability of adequacy requirement and convert, will not enjoy the debt waiver relief.

A defined pension commenced on or after 20 September 2004 and before 20 September 2007 will be able to rollover to a market linked pension and retain their ATE exemption. There are very few such pensions. Most were commenced before 20 September 2004.

The debt that would otherwise arise from a pre 20 September 2004 defined pension being converted to a market linked pension under Section 1223A of the Social Security Act 1991 is waived by the Minister under Section 1237AB of the Act.

7. THE EXCHANGE CONVERSION AMOUNT

Centrelink Policy Guidance notes require **ALL ASSETS OF THE COMMUTATION** should be used to purchase the new market linked income stream. This is very different to **ALL ASSETS OF THE RESERVES**. Not all Centrelink Complex Assessment officers appreciate the difference.



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The ATO has yet to clarify exactly what is acceptable as conversion amounts. For Centrelink clients this is not an issue because they can usually only undertake a conversion if a sharp drop in assets has placed them in an inadequate or “non performing” situation. Exchange conversions of this level of assets do not normally run much risk of being treated as a contribution i.e. the assets are lower than what the ATO will probably accept as a reasonable exchange.

8. ENTITLEMENT AND INCOME RAMIFICATIONS

The member may be in the situation where the Age Pension entitlements are reduced at the same time that the level of income that can be provided by the SMSF is reduced. This is going to depend heavily on individual circumstances especially which mean test (income or assets) dominates. There may be some optimization possibilities.

9. PRACTICAL ISSUES

The conversion exchange will need to be documented with the usual letter of request from the member, trustee minutes of terms offered and acceptance of those terms by the member. Make the exchange conditional on Centrelink accepting the conversion or it becomes null and void.

This note considers actuarial aspects of values and reserves. It is imperative that proper financial planning advice is obtained. These general comments are no substitute for that advice. Additional estate planning issues and general financial planning objectives will need to be revisited.

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