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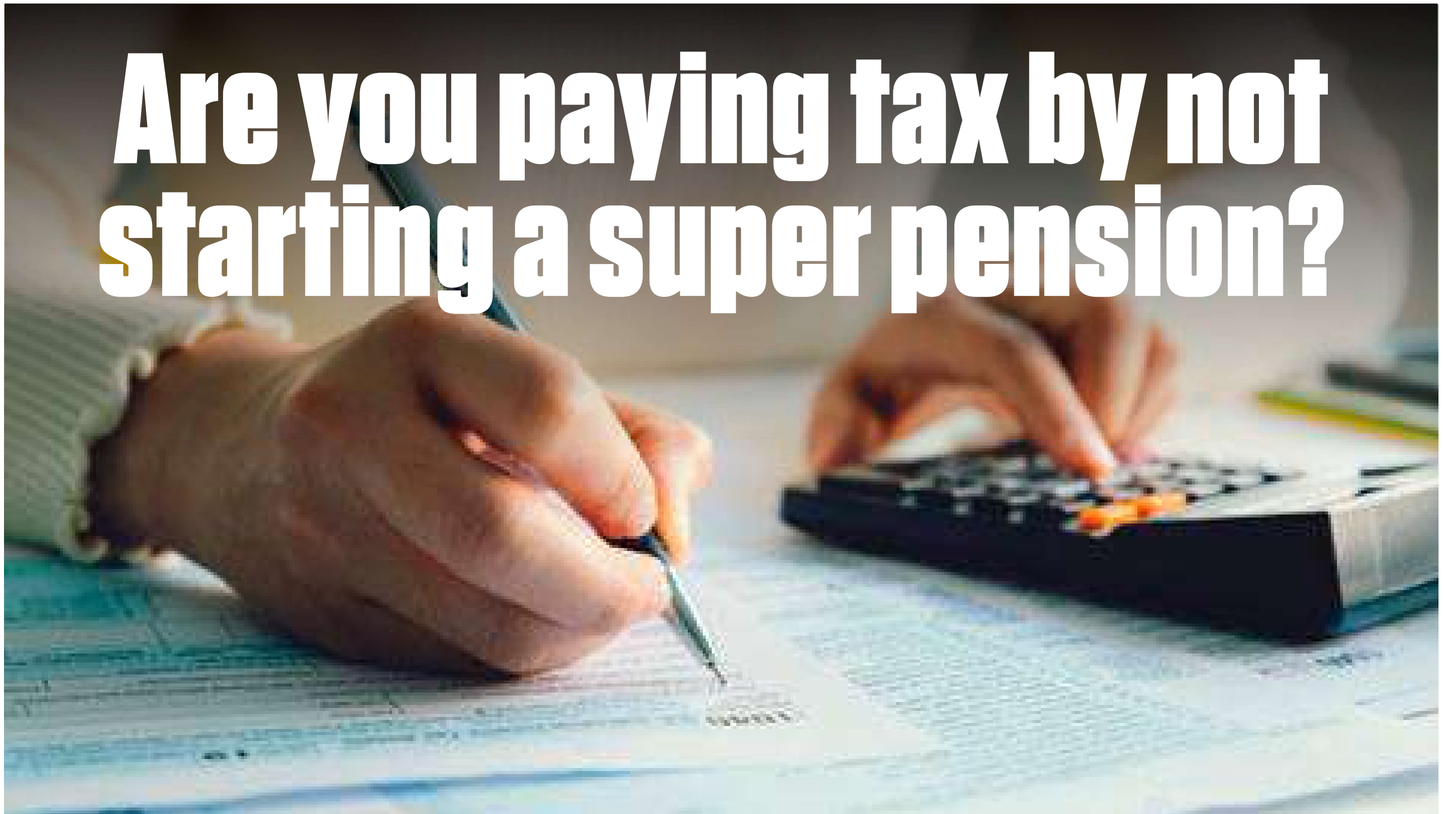

Are you paying tax by not starting a super pension?

BY GRAHAM HAND

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Over age 60, superannuation benefits paid as either a lump sum or pension are tax free and not assessable for income tax. Why doesn't everyone convert from accumulation to pension as soon as possible? In the recent Class Benchmark Report, one graphic stood out. While only 12% of SMSF members aged 65 and over remained entirely in accumulation, half of APRA fund members over 65 had not switched any of their super to pension. The amount not switched to pension by over 65s is estimated at $225 billion. They may be paying too much tax and should be advised of the choice.

In the accumulation phase, investment earnings are taxed at 15%, whereas the tax rate is nil in pension phase provided certain rules are met. As the ABS data below shows, retirement from the workforce, and therefore eligibility for a super pension, is most common in the 60-64 age group for both men and women, with high numbers for age 65 and over. For some, the pension opportunity starts at 60.

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BEFORE YOU GET STARTED

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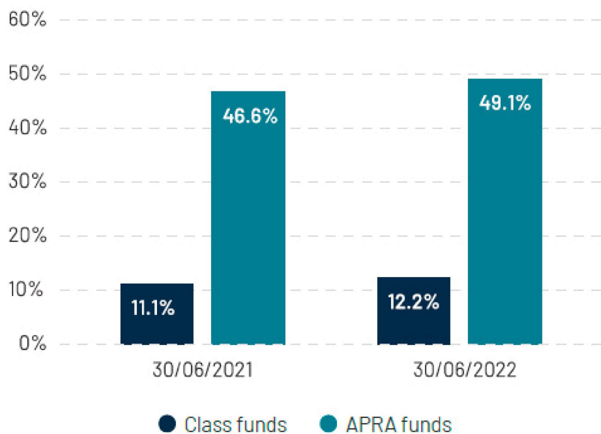
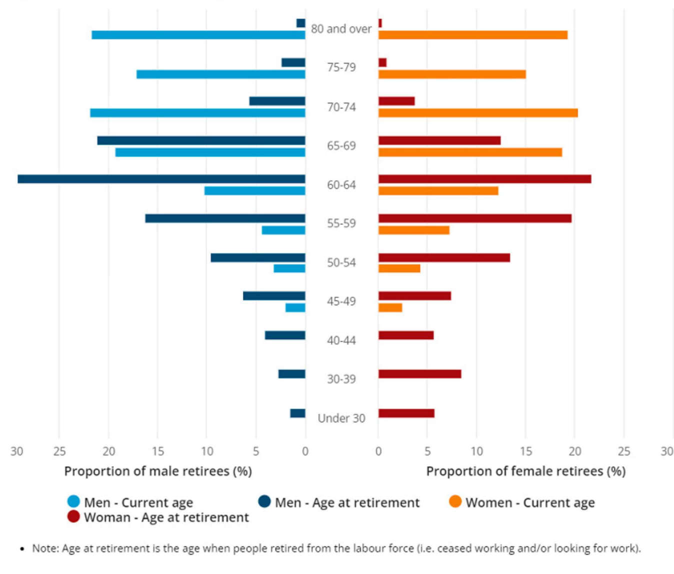
Class vs APRA members over 65 who are purely in accumulation phase



Age distribution of retirees aged 45 years and over, 2020-21



What are the conditions to start a pension?

Starting a pension in superannuation is not complicated and it does not require a change in thinking from saving to spending. While withdrawals must be made from a super pension account each year, the money does not need to be spent and can be saved outside the pension account. Sometimes, the superannuant can continue working.

(A super pension should not be confused with the Age Pension from the government. There are also Transition to Retirement (TTR) income streams which do not carry the same tax benefits. Check your personal circumstances with a financial adviser before taking any action).

The Conditions of Release to start a super pension are:

- reach preservation age and permanently retire
- cease employment after the age of 60 even if later return to work
- age 65 years and over, even if not retired.

Preservation age varies between 55 and 60 depending on date of birth. There are other special circumstances which we won't dwell on for the purposes of this article.

The opportunity from the age of 60 is probably less known than the eligibility for a super pension at age 65. Super pensions are flexible with a minimum of 4% of the balance drawn out each year, depending on age. New contributions cannot be made to a pension fund but an accumulation fund can operate at the same time and accept contributions.

Super of $400,000 earning say 8% a year generates $32,000 a year of investment income, which at 15% is $4,800 a year.

The maximum that an individual can transfer from accumulation to pension is determined by the personal Transfer Balance Cap (TBC), currently $1.9 million.

Why members do not start super pensions

On the surface, a tax rate of nil versus 15% looks like a no-brainer, but half of APRA fund members do not lower their taxes after the age of 65. Some may be eligible for a pension account from the age of 60.

What's happening?

1. Many members do not know about the tax treatment, especially those in APRA funds. They do not focus on their superannuation, the rules are too complicated, their super fund has not informed them or they haven't opened the mail. Tax is deducted at the fund level so the tax payment is not apparent. It's more likely that SMSF trustees are advised by either a financial adviser or accountant.

Liam Shorte of Sonas Wealth said:

"From experience, the biggest reason is that people who have not received advice think you cannot move in to pension phase until you stop working.

The second biggest reason is that those working often put it in the too hard basket as they have enough from employment income to meet their living expenses and just leave super until they need it as they do not understand or know about the tax benefits of pension phase.

No matter how many letters the industry funds send them, if they don't open the letters or feel it is advertising, they just ignore the call to action.

Last year I took over a client who was 84 and finally retired, closing his business, and had super that he was told 20 years ago he could access when he stopped working and so he never did anything about it until he actually retired!"

Large super funds must accept some blame for not identifying their members at the age of 60 or 65 more actively

and explaining the options. AustralianSuper has proposed a scheme where all members over 65 are automatically converted to pension with an opt out, in coordination with the Age Pension.

As ASIC and APRA said in their July 2023 Review on the Implementation of the Retirement Income Covenant (RSE=Registrable Superannuation Entity):

“Overall, there was a lack of progress and insufficient urgency from RSE licensees in embracing the Retirement Income Covenant to improve members’ retirement outcomes.”

2. Some members do not want to draw down their superannuation preferring to build the balance within super for retirement spending when needed. Perhaps they do not realise that the money does not need to be spent and can be invested in another vehicle.

3. An account-based pension may affect entitlement to social security benefits, although this is unlikely to impact most SMSF trustees. Lyn Formica of Heffron advised:

“In terms of the social security income test, there can be an incentive not to start a pension but only when an individual is below Age Pension age. This is because no amount is counted as income in respect of accumulation account balances (ie there is effectively no deemed income) for individuals below Age Pension age. But when an account-based pension is commenced, whilst actual pension payments are ignored for income test purposes, a deemed amount of income is counted.

Once an individual reaches Age Pension age, the income test treatment of leaving monies in accumulation phase or commencing an account-based pension is effectively the same.”

Again from Liam Shorte:

“For some, when they meet a Condition of Release like retiring after age 60 or reaching 65, they deliberately delay the move to pension phase if they are part of a couple where the older one is getting the Age Penson or Disability Pension. They may lose or receive a lower benefit if the younger partner moved to pension phase earlier than when accumulation is counted as an asset at 67.”

4. According to the Class Report, far more APRA fund members withdraw lump sums in larger amounts after satisfying a Condition of Release (including reaching 65) than the number of members who commence a pension and withdraw progressively. Their evidence suggests many retirees are withdrawing the entire balance after they become eligible rather than opening a pension account.

This may be financially appropriate where, for example, paying off a mortgage allows higher eligibility for an Age Pension while reducing or eliminating mortgage payments (and the value of an own home does not count in the assets test whereas a superannuation balance does). Says Joshua Williams, writing in the Class Report:

“The total number of members between 60 and 64 (1,573,352) drops to less than half that number 10 years on, in the 70 to 74 cohort (707,353). Most are choosing not to preserve their benefits in the superannuation environment at all. It wouldn’t be fanciful to imagine that, after repaying the mortgage on the family home, splurging on a new car and a cruise, most of us will end up relying on the Age Pension after all!”

The need to educate on tax benefits

While it is worthwhile reviewing individual circumstances against this list of reasons, for the most part, the failure to switch to a pension fund is due to a lack of familiarity with the opportunity.

In the 2023 Intergenerational Report, withdrawals from superannuation are estimated to increase from about 2.4% of GDP per annum in 2022-23 to 5.6% of GDP in 2062-63. There is a big incentive for millions of older Australian to realise the tax advantages of pensions.

It’s surprising that only one APRA fund member in every eight over the age of 65 has converted their superannuation entirely from accumulation to pension, and educating members on the opportunities is essential. They could save thousands a year in tax.

Firstlinks is a publishing service providing content written by financial market professionals with experience in wealth management, superannuation, banking, academia and financial advice.

BY GRAHAM HAND

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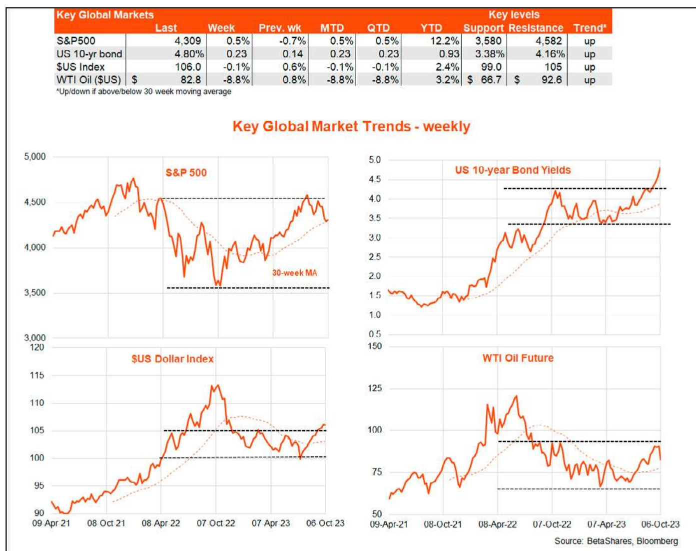
Global markets

US equities managed to squeeze out small gains last week despite a further rise in bond yields, likely helped by a slump in oil prices and easing US wage inflation. Even the NASDAQ-100 bounced back 1.8%.

Whether this is merely consolidation remains to be seen, with Hamas attacks on Israel over the weekend likely to now lead to nervousness over the oil price and inflation outlook, given the risk of tighter restrictions on Iranian exports.



Key Global Markets	Last	Week	Prev. wk	MTD	QTD	YTD	Key levels Support	Key levels Resistance	Trend*
S&P500	4,309	0.5%	-0.7%	0.5%	0.5%	12.2%	3,580	4,582	up
US 10-yr bond	4.80%	0.23	0.14	0.23	0.23	0.93	3.38%	4.16%	up
$US Index	106.0	-0.1%	0.6%	-0.1%	-0.1%	2.4%	99.0	105	up
WTI Oil ($US)	$ 82.8	-8.8%	0.8%	-8.8%	-8.8%	3.2%	$ 66.7	$ 92.6	up

*Up/down if above/below 30 week moving average

In terms of key events last week, markets were initially spooked by a rebound in US job openings – the decline of which over recent months had given rise to hopes of an easing in excess labour demand without the need for a recession. Despite the monthly rebound, however, the broader trend still appears downward.

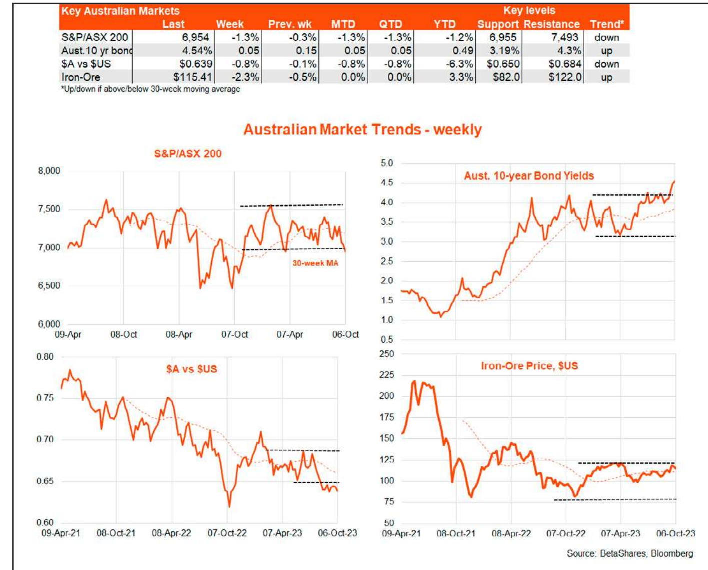
Similarly, markets were initially spooked by Friday's much larger-than-expected US employment gain of 336k in September, though then took some comfort from the fact the unemployment rate managed to hold steady at 3.8% and annual wage growth eased further from 4.3% to 4.2%. All this suggests that despite ongoing solid US employment demand, rising labour supply is helping to contain labour cost pressures.

Oil prices slumped 8.8% last week reflecting Russia's announcement that it would lift its self-imposed partial ban on oil exports, along with more general market concerns that higher prices may start to slow demand.

In the week ahead, initial attention will naturally focus on the oil market – with at least a knee-jerk upward move in prices likely. Otherwise, a key focus will be the US September CPI report on Thursday (US time), with flatter oil prices likely to produce a smaller 0.3% gain in headline prices after August's 0.6% spike. Core inflation is expected to rise by a reasonably modest 0.3% again. If achieved, these results should not overly rile the bond market further as they would be consistent with the Fed leaving rates on hold at the November policy meeting.

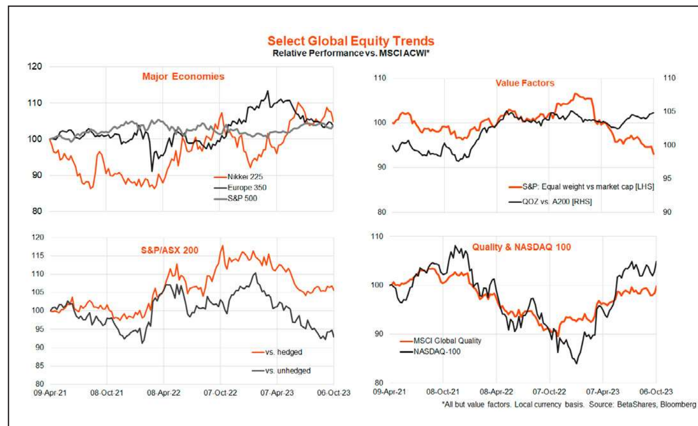
Note also this week marks the start of the Q3 US earnings reporting season. Given the resilient economic outlook, overall reports are likely to remain encouraging, which could give Wall Street some reason to cheer even in the face of high bond yields. After a flat 2023, markets continue to expect solid US earnings growth of just over 10% in both 2024 and 2025.

Minutes to the latest Fed policy meeting are released on Wednesday (US time), along with September producer prices.



Key Australian Markets	Last	Week	Prev. wk	MTD	QTD	YTD	Key levels Support	Resistance	Trend*
S&P/ASX 200	6,954	-1.3%	-0.3%	-1.3%	-1.3%	-1.2%	6,955	7,493	down
Aust.10 yr bond	4.54%	0.05	0.15	0.05	0.05	0.49	3.19%	4.3%	up
$A vs $US	$0.639	-0.8%	-0.1%	-0.8%	-0.8%	-6.3%	$0.650	$0.684	down
Iron-Ore	$115.41	-2.3%	-0.5%	0.0%	0.0%	3.3%	$82.0	$122.0	up

*Up/down if above/below 30-week moving average



Australian market

Local equities declined further last week, though are yet to benefit from Friday's solid rebound in the US market. Renewed Middle East tensions on the weekend, however, may hold back today's market bounce. Bond yields rose further and the $A sank, as the US 'no landing' scenario remained the overriding global narrative.

In terms of major highlights last week, the RBA (under new Governor Michele Bullock) left interest rates on hold for the fourth month in a row, though the accompanying statement retained a modest tightening bias.

That said, pressure may well be building for another rate increase, with growing signs of economic resilience. ANZ job ads were flat in September after rising 1.9% in August – a tentative sign of stabilisation at a still high level following earlier declines from last's year peak.

Of more RBA concern, national house prices continued to charge ahead, with Core Logic reporting a further 0.8% gain in September. House prices are now a whisker away from their record highs achieved early last year.

Against this backdrop, key local events this week include the Westpac and National Australia Bank surveys of consumer and business sentiment respectively. Business sentiment is likely to hold at a robust level, while it would not surprise if still subdued consumer sentiment finally rebounded somewhat given steady official interest rates in recent months, easing inflation, higher house prices and reduced fear of recession.

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Australian banks pass rigorous stress test by APRA

BY GLENN DYER

Republished from sharecafe.com.au

Australia's major banks have successfully navigated the latest stress test conducted by the Australian Prudential Regulatory Authority (APRA).

Based on the parameters set by APRA, this test was exceptionally stringent, bordering on the unbelievable. Nevertheless, APRA has confirmed that all tested banks have emerged unscathed from the hypothetical economic and financial downturn.

APRA's stress test assessed the resilience of the banking system under the assumption of a 'hard landing' for the economy. This scenario included a surge in unemployment to 10%, high inflation, and a one-third decline in house prices, reminiscent of Australia's 5.3% house price decrease in 2022 due to rate hikes by the RBA.

Remarkably, these challenging conditions did not lead to any breaches in the banks' capital or liquidity buffers. In a speech delivered in Sydney, Australian Prudential Regulation Authority Chairman John Lonsdale referred to these economic assumptions as "severe yet still plausible" and hailed the stress test results as highly favorable.

Eleven major banks, including the big four, participated in this year's test, the first to employ the new bank capital framework introduced in the current year. Lonsdale mentioned, "We are still in the process of reviewing the results, which will be published externally early next year."

Following his speech, bank shares experienced a significant uptick on Thursday. The big five banks—CBA, Westpac, NAB, ANZ, and Macquarie—saw gains ranging from 0.4% to just under 1%. This occurred on a day when the broader market struggled, managing only a modest 2.6-point increase by the end of trading.

Lonsdale assured, "What I can tell you now is that no banks breached their prudential requirements on capital, all retained sufficient liquidity, and banks continued to provide credit to households and businesses. Although a hypothetical exercise, these results provide confidence in the overall financial system resilience."

He explained that APRA's stress test scenarios aim to be severe yet still plausible, often including non-financial shocks, such as natural disasters or major cyber-attacks, in addition to economic factors like domestic recessions and high unemployment.

Lonsdale drew attention to lessons learned from the US experience, where bank runs and failures, while not directly impacting Australian banks, emphasised the importance of a strong regulatory architecture and the risks associated with the digital finance revolution. He emphasised that even banks considered not "systemically important" can undermine confidence and financial stability if they fail, thanks to the rapid spread of bank runs.

In recent months, APRA has worked to further strengthen the Australian banking system to withstand future shocks. They are enhancing areas such as liquidity and interest rate risk requirements and evaluating the effectiveness of Additional Tier 1 (AT1) instruments designed to stabilise banks in distress or support resolution in the event of failure.

To ensure Australia's banking system is prepared for this new reality, APRA will continue to push boards to elevate their risk management standards and is ready to take swift and decisive action to address weaknesses before they become serious problems.

Glenn Dyer has been a finance journalist and TV producer for more than 40 years. He has worked at Maxwell Newton Publications, Queensland Newspapers, AAP, The Australian Financial Review, The Nine Network and Crikey.

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Q&A: Ask a Question

Question 1

I want to start saving up for my child's education and I have read about investing in education bonds. What is an education bond and how does it work?

An education bond is a type of investment designed for saving towards educational expenses, typically for children. It offers tax benefits where the tax on the earnings is deferred. This means you will not need to pay tax on the income the education bond earns each year.

When you open an education bond, you nominate a beneficiary and you need to ensure that the funds are used for their education needs. Contributions can be made regularly or as lump sums, accumulating over time within the bond. The investment options offered allow you to choose the strategy aligning with your financial goals and risk tolerance.

Tax concessions apply when you make withdrawals from the bond for qualified education costs, such as school fees, uniforms, and textbooks. Each education bond provider will have clear guidelines for what expenses qualify. Some education bonds may have lock-in periods encouraging long-term saving.

Education bonds can also play a role in estate planning, ensuring a smooth transfer of funds to the nominated beneficiary in case of the bondholder's passing.

Keep in mind that regulations may change, so consulting with your financial adviser is essential for the most current information on how education bonds work.

Question 2

Everyone around me is saying that establishing an Self-Managed Super Fund is the best way to get rich. What are some indicators that an SMSF is suitable for me?

A Self-Managed Super Fund (SMSF), can be a suitable choice for individuals who desire greater control over their superannuation investments. An SMSF may be suitable for you if you have a strong grasp of financial matters and you value the ability to make direct investment decisions within your superannuation fund. Another typical indicator is having a substantial account balance as an SMSF more cost-effective when the balance is larger as many of the costs are fixed such as paying an accountant to complete tax returns for the fund.

Furthermore, if you have specific investment preferences that are outside of what traditional retail superannuation funds offer, an SMSF allows you to invest in a wider range of assets, including direct property and private equity.

However, managing an SMSF is administratively intensive, requiring strict compliance with superannuation regulations which can be expensive to outsource. Seeking professional advice from your financial adviser is essential to determine if an SMSF aligns with your financial goals and to assist in navigating its complexities effectively.

Question 3

My income protection premiums have significantly risen, and it is really affecting my cashflow. What are some ways to reduce my premiums for Income Protection?

With rapidly rising insurance premiums, managing the costs while maintaining adequate coverage is a common aim for many individuals. To achieve this, there are several strategies to consider. First and foremost, shop around and compare quotes from various insurance providers to find the most competitive rates. Each insurer may offer similar coverage at differing prices.

You can also adjust your policy parameters to lower costs. Opting for a longer waiting period before your income protection benefits begin, such as 60 or 90 days, can reduce premiums. Similarly, selecting a shorter benefit period, say five years instead of until age 65, can also result in cost savings. However, it's crucial to strike a balance between affordability and adequate protection. Maintaining a healthy lifestyle, choosing an accurate occupational rating, and bundling policies with the same insurer can also lead to potential discounts. Lastly, consider paying your premiums annually instead of monthly for cost savings, and periodically review and update your policy to align it with your current situation. It is important to you to see your financial adviser who can work these through with you and advise you on the best course of action for your circumstances.

If you have a question that you would like to see answered in **Wealth Adviser**, please send it through to **centraladvice@wtfglimited.com.**

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