

Retirees juggle precious capital

The bear market calls for new strategies.

By John Kavanagh

Retirees anxious to preserve the capital in account-based pensions are reviewing a strategy that involves cashing in the pension and starting a new one with a smaller income stream.

Retirees have discovered that one of the drawbacks of account-based pensions (the new name for allocated pensions) in a bear market is that superannuation rules require a minimum level of income be paid from the account each year – even in years when the assets supporting the pension are losing value.

Many retired people have seen the value of the capital they have invested in account-based pensions fall alarmingly during the past year.

One way to slow the flow of money out of the pension is to commute it and start again with a lower minimum income payout (commutation means cashing in the pension).

Minimum pension payments are set each July 1 for the financial year ahead. The minimum varies with age: a person younger than 65 must draw a minimum pension equivalent to 4 per cent of the account balance each year; a person aged between 65 and 74 must draw 5 per cent a year; between 75 and 79 it is 6 per cent; between 80 and 84 it is 7 per cent; between 85 and 89 it is 9 per cent.

A person aged 65 who established an account-based pension on July 1 last year with \$400,000 of capital would have to draw a minimum pension of \$20,000 (5 per cent of \$400,000) in the year to June 30.

Even if the account balance has fallen sharply since the establishment of the pension, the minimum pension of \$20,000 must still be paid.

According to the technical services manager of ING Australia, Rudy Haddad, an alternative would be to commute the pension and establish a lower minimum payment with a fresh pension.

“Assume that on January 5 the value of the \$400,000 invested in the pension back in July has fallen to \$320,000,” he says. “The pension has already paid out \$10,000 of the minimum annual payment and at commutation, there would be a residual payment of \$356, leaving a balance of \$319,644.”

The minimum income to be paid on the new pension in the six months to the end of June would be \$7710. The retiree has been able to reduce pension payments in the second half of the year from almost \$10,000 to \$7710 – thus preserving precious capital in what may be an ongoing bear market.

“Retaining the existing pension would result in a further \$10,000 in

pension payments for the financial year,” Haddad says. “But there are a lot of factors at play and the strategy may not be beneficial to all.”

One of those factors is the Centrelink asset and income test. On the original pension, the Centrelink deductible amount (the amount not assessable for the test) would be \$22,599. On the new pension, Haddad estimates the deductible amount would fall to \$18,059.

“In this example, there would be some cost to the retiree if they are a Centrelink recipient, because the deductible amount has been reduced,” he says.

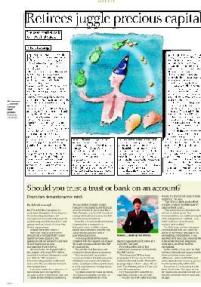
“The Centrelink impact will vary from case to case.”

A partner at superannuation law specialists Townsends Business and Corporate Lawyers, Michael Hallinan, says he has seen several advisers using this strategy.

“Retirees are definitely looking to reduce their pension income from super,” he says.

“People think they only have to take the earnings out of their account-based pension each year.

“Many are only now realising that they have to take that minimum amount even if the pension account



makes a loss.”

Hallinan warns that the commutation strategy only works if the retiree makes a full commutation of the pension and sets up a new one. He says a variation on

the strategy, which further reduces the income draw-down, is to commute the pension and put some of the proceeds into an accumulation fund and the balance into a new pension.



**Do the sums
... consider
taking a
lower
pension.**

Illustration:
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