# Overview of defined benefit pensions

15 October 2014

A defined pension as defined under Section 9A or 9B of the Social Security Act[1] exchanges a purchase price for a specific defined income stream. The member ceases to have an interest in the assets and the income stream is not linked to the account balance. Once the terms of the defined pension are set up they cannot be changed. For example, a pension of $10,000 per annum increasing by 2% guaranteed each 1 July with no reversion.

Defined benefit pensions are, as the name suggests, defined and the pension payment requirements do not depend on the account balance. The trustee must pay the specified pension amount as defined under the terms of the pension each financial year.

In the May 2004 budget it was announced that funds had to have at least 50 members in order to offer a defined benefit pension i.e. preventing SMSFs from offering this type of pension. After various extensions, this came into effect on 1 January 2006.

Defined benefit pensions are either 100% asset test exempt for social security purposes or 50% assets test exempt depending upon the date they were commenced.

Defined benefit pensions require an actuary's statement of adequacy opinion each year. This opinion will state whether, in the actuary's opinion, there are sufficient assets on an 'average' Best Estimate basis (50% probability) backing the defined benefit pension to meet all future liabilities. The actuary will also issue a 'High Probability' adequacy opinion for Centrelink purposes. This is a more conservative adequacy level, it determines whether there is a 70% likelihood that there are sufficient monies to meet all future liabilities.

Where a defined benefit pension does not meet the high probability adequacy level, and the member receives Centrelink benefits, the member may be required to commute the defined benefit pension if they cannot in conjunction with the actuary determine that the defined pension is adequate. Due to the large investment losses experienced during the global financial crisis many defined benefit pensions became inadequate, that is they failed the high probability test of adequacy.

There are generally two alternatives for this commutation.

The defined benefit pension may be restructured by purchasing a similar retail product, e.g. a life office annuity. The income stream will need to be purchased outside of the SMSF. It will continue to be assessed as asset-test exempt under this scenario.

Alternatively, the defined benefit pension can be restructured into a market-linked income stream either within the SMSF or from a retail provider. This market-linked pension may be 100% asset tested for Centrelink purposes depending on the commencement date of the original pension.

1 Australia Taxation Office, Preserved and non-preserved benefits.

Phone: 1800 203 123
act@accurium.com.au
www.accurium.com.au

The information in this document is provided by Accurium Pty Limited ABN 13 009 492 219 (Accurium). It is factual information only and is not intended to be financial product advice or legal advice and should not be relied upon as such. The information is general in nature and may omit detail that could be significant to your particular circumstances. While all care has been taken to ensure the information is correct at the time of publishing, superannuation and tax legislation can change from time to time and Accurium is not liable for any loss arising from reliance on this information, including reliance on information that is no longer current. Tax is only one consideration when making a financial decision. We recommend that you seek appropriate professional advice before making any financial decisions.

17519/1014