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SHOULD RETIREES CONSIDER REDUCING THEIR PENSION PAYMENTS DURING COVID-19?

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Investment markets across the world have seen sharp falls and increased volatility as a result of the COVID-19 crisis. Off the back of this, many Australians have experienced a decrease in their retirement savings. As part of the COVID-19 stimulus measures, the Australian government has announced a reduction in the minimum pension withdrawal requirements for account-based pensions ('ABPs'). In this article, we outline what the government changes mean for retirees and outlines four key considerations for those thinking about reducing their pension drawdowns to help protect their super balance.

What are account-based pensions (ABPs)?

ABPs are commonly used and can be a tax effective investment structure for some Australians. There is no tax payable within pensions or when you withdraw money from them where you are aged 60 or above. This can make them a particularly attractive structure compared to holding retirement savings in your own name, where standard marginal tax rates apply. As they are designed to be a retirement savings vehicle, ABPs have mandated set minimum pension withdrawal levels based on the ABPs account value and the account holder's age as at 1 July each year. The old and the new minimum pension withdrawal rates can be seen below:

Age as at 1 July	Old rates	New rates
Under 65	4%	2%
65-74	5%	2.5%
75-79	6%	3%

80-84	7%	3.5%
85-89	9%	4.5%
90-94	11%	5.5%
95+	14%	7%

Note: at this stage, the new minimum pension withdrawal rates apply for the 2019-20 and 2020-2021 financial years only.

How are ABPs invested?

ABPs are predominantly invested in a range of assets including Australian and international shares, property, fixed interest, cash and alternatives. The investment returns from these assets are received in the form of income and capital.

Income is comprised of dividends, distributions, rent and interest while capital returns can be observed in the fluctuating value of the portfolio. Many investors rely predominantly on the income returns within their ABP to fund their pension payments, and in turn, their lifestyle in retirement.

If you utilise a platform or Self Managed Super Fund (SMSF) to manage your super, you have greater control over the decision as to how to fund your ABP pension payments. However, industry and retail pension funds make the draw down decision on an individual's behalf each time they pay out a pension payment. In saying that, regardless of the style of ABP used, all of them are required to make the relevant minimum pension withdrawal each year.

Why would I consider reducing my pension payments?

The Australian Prudential Regulatory Authority (APRA) has recently applied pressure on Australian banks and insurers to suspend dividends and cut bonuses to executives during the COVID-19 crisis. Furthermore, many non-financial services companies have announced a reduction or cancellation of their upcoming dividends. We have also seen similar action around the world with banking dividends in the UK and NZ banned and many other companies flagging a need to retain cash during the crisis. In addition, the slowing of the economy will reduce rental inflows of both corporate and residential tenancies and cash rates are at globally historical lows.

Based on this, ABP holders will likely experience a drop in the income generated by their investments. So instead of primarily using income for the required minimum pension payment, they may instead be required to sell down their investments to fund payments. The down-side to this is that these assets are currently trading at deflated prices, and likely below their long term value. By reducing the amount of your pension payments, this may reduce the need to sell your assets enabling you to retain more in your ABP accounts to participate in a recovery, which assists in sustaining your pension assets (and your retirement income) for a longer period.

Why is the Government reducing the minimum pension withdrawal rates?

Concern surrounding the impact of deflated share/property prices as a result of the COVID-19 crisis, and a corresponding expected decrease in income yield is the key reason the Government has reduced the legislated minimum pension withdrawal rates for the remainder of FY20 and all of FY21.

This means that, where possible, other forms of retirement savings can be utilised, such as surplus cash balances, rather than being required to withdraw from superannuation at an unideal time. The Government appreciates where assets are sold within an ABP at low prices in order to fund pension payments, this will mean there are less assets within the ABP – all things being equal - when the market recovers.

Four key considerations when considering to reduce your pension payments

1. Do you have any liquid assets outside of the superannuation environment you can draw on to help offset any reduced pension income?
2. Do you already receive excess income from your pension, and therefore can meet ongoing expenses from a reduced pension payment?
3. Do you have the ability to control which investments you sell down in your pension portfolio? For example, are you able to sell down cash/fixed interest funds in the short term instead of shares?
4. During this time of self-isolation, are you likely to reduce your expenditure and therefore able to sustain your lifestyle with a reduced pension?

If you are not in a position to reduce your pension payments, don't stress, you still have options. A skilled financial adviser can work with you to determine how to manage your finances during this time of crisis. Advisers will often create portfolios with a large amount of flexibility and control. They can quickly implement new drawdown strategies with appropriate consideration provided to

meet long term retirement needs. For example, this may mean prioritising selling down ‘overweight’ conservative investments to fund pension payments instead of selling shares at ‘low’ valuations.

In most industry and retail funds, there isn’t the flexibility to take advantage of the current market conditions, or any control held for these decisions to be tailored to an individual’s own personal circumstances and financial goals.

Managing your finances can be complex and confusing at the best of times. We are in the midst of extreme investment market volatility, record low cash rates and a smorgasbord of short-term regulatory change. Now more than ever is the time to seek quality financial advice to ensure you successfully manage your investments throughout the market volatility and take advantage of changes to legislation to aim towards a secure financial future.

FURTHER READING - COVID-19

Visit our COVID-19 Insights Hub for economic and market updates to keep you informed as the situation evolves.

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