FSC FINANCIAL SERVICES COUNCIL

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Social security means testing of retirement income streams

The Financial Services Council (FSC) welcomes the Department of Social Services consultation on proposed reforms to facilitate the opening of the retirement income streams market.

The FSC strongly supports the Government's announced intention to implement the Financial System Inquiry's recommendation to introduce Comprehensive Income Products for Retirement, now known as MyRetirement. The DSS consultation is an important element of implementing those reforms.

The Financial Services Council (FSC) has over 110 members representing Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, licensed trustee companies and public trustees. The industry is responsible for investing more than $2.6 trillion on behalf of 11.5 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the third largest pool of managed funds in the world.

The Financial Services Council promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

Please contact me with any questions in relation to this submission on (02) 9299 3022.

Yours sincerely,

Blake Briggs
Senior Policy Manager

1. Introduction and Question 1 and 2

The Financial Services Council (FSC) supports the Government's policy to remove tax, social security and regulatory barriers to open the market for new retirement income stream products particularly those that address issues of longevity risk.

Reforms to the retirement phase of the superannuation system are necessary to more efficiently achieve the objective of the superannuation system; raise standards of living of Australian retirees and reduce Age Pension reliance of future retirees.

The FSC notes that the current consultation is in the context of the Government's broader implementation of the tax changes announced in the 2016 Budget and ongoing consultation by Treasury in relation to the implementation of the Comprehensive Income Products in Retirement (MyRetirement products) reforms recommended by the Financial System Inquiry. The FSC encourages the DSS to ensure that it is considering social security changes in the context of this broader package of reforms.

The importance of the social security treatment of retirement products cannot be understated. There are options canvassed in the DSS consultation paper that, if implemented, would ensure that the Government's policy objective of opening the retirement income product market would not succeed. The FSC notes that whilst our submission focuses on the model for social security treatment that has the support of insurers and superannuation trustees that are members of the FSC, these are not simply our preferred option, but what the FSC believes is necessary to ensure the Government's policy is successfully implemented.

To assist in clarity, this submission provides an initial high level response to the approach taken by the DSS in relation to the consultation paper, and then addresses each of the questions posed.

<u>Conceptualising MyRetirement products</u>

The FSC has observed disconnect between the DSS discussion paper and the Treasury discussion paper in how they conceptualise the delivery of the Government's retirement incomes policy. The FSC submits that the appropriate approach is to consider a retirement income product as the sum of its parts – that is a retirement product may be any combination of an account based pension, an annuity, a deferred annuity, a group self-annuity, or other yet-to-be-developed structures, where that combination meets minimum standards established through legislation and regulation.

This approach is important as it reflects a consumer's experience of their retirement income. In an optimal policy environment a consumer would have a seamless view of their retirement income product and its overall treatment. This does not require complex engagement by the consumer on the detailed component parts of their retirement income products. This approach is consistent with that taken by Treasury in its MyRetirement consultation paper. It is also useful to articulate as part of this consultation as it may help DSS shape how it approaches its development of social security parameters for new components of what will be a single part of a multifaceted financial product.

The FSC also supports the DSS, and the Government more broadly, continuing to take a principles-based approach to regulation in this area to enable product innovation in this market. Consumers' needs, and the industry's capacity to meet these needs, will evolve and improve over time, and as such a flexible framework is critical to allowing the market to develop.

Recommendation: The social security treatment of income stream products be considered in the context of the broader objective of enabling MyRetirement products to be offered and the Government continues with a flexible, principles-based approach.

Policy principles

The FSC broadly agrees with the policy principles outlined by DSS in the consultation paper.

The FSC is concerned, however, that the 'neutrality' principle misapplies neutrality in the context of the current social security treatment of retirement income products requires amendment.

The current social security treatment does not offer product neutrality as there are important categories of product that would materially improve the efficiency of the superannuation system that are unable to come to market as a result of social security settings.

Neutrality between products should also mean treating products with the same or similar features or outcomes in the same way. That is, there should be no favouritism for a particular product. Genuinely neutral policy settings would enable all relevant products to come to market and allow consumers to decide which product features best suit their needs.

In effect the current social security settings devalue certain product characteristics, such as non-commutable deferred annuities or group self-annuities that defer income, in favour of products with different characteristics, such as immediate income streams with flexible access in terms of income and lump sums (eg account-based pensions with limited features to manage longevity risk).

The current settings are inconsistent with basic definitions of neutrality and makes the decision on behalf of consumers as to which features should be allowed to come to market.

Recommendation: The neutrality principle should be amended, but that the principles are otherwise appropriate as defined.

Concessionality of current rules (lifetime income streams)

The paper states that the current assets test treatment is 'quite concessional' compared to other products and also that they are 'highly concessional' beyond life expectancy.

We disagree with these statements and the reasoning set out in the paper. In particular we suggest that:

- for those people who do not reach life expectancy, it is arguable that the test is in fact punitive; and
- modelling typically shows that for those who exceed life expectancy it is the income test (not that assets test) that has the greater impact.

Other observations

Any approach to the capital reduction (whether straight line or otherwise) should run down capital to a person's life expectancy age. The paper contemplates an approach in para 37 that shows reductions to age 100. For pooled products, using life expectancy means in aggregation of means tests on community basis whereby those who die early are penalised and those who die later benefit from assets and income testing – but on average it balances out. The paper's approach of using age 100 (or some advanced age) mean that averaging process would not work.

The FSC also supports using a revised calculation of life expectancy in the means testing calculations (for deductibles etc) which could be determined incorporating expected mortality improvements (utilising the Australian Government Actuary's 25 year improvement rates). This would increase the

amount of assets tested and would more closely represent the underlying capital drawdown as well as being consistent with the actuarial assumptions used in pricing.

2. Question 3 and 4 – Capital schedule

Question three relates to approaches to income and assets testing income streams during the deferral period that would meet the policy principles outlined in the paper.

Products with no access to capital

The means test treatment of deferred products, where the product provides no access to capital, it is a risk product and should be exempt from the asset test and income test during deferral. If the retiree survives to the trigger date for payment the asset and income tests should be calculated in the same way as for deferred and immediate products that meet the capital access schedule and apply from the date the risk product commences to pay.

Once payments commence, the current reduced purchase price approach should be applied, where the Relevant Number is the determined as life expectancy of a person who reaches the deferral age), this would be set at purchase.

Other products

For other products which meet the capital access schedule, should be completely consistent with the current treatment of non-account based income streams such as lifetime annuities. They should be asset tested using reduced purchase price from the date of purchase, or the date on which the deferred product becomes eligible for the pension phase earnings tax exemption, if that is a later date. The reduced purchase price should be calculated as a straight line from the purchase price to zero at life expectancy at date of purchase. This is the same calculation as is currently applied for immediate non-account based pensions, such as lifetime annuities, using the Relevant Number.

The income test for non-commutable, deferred products should be the income received in each year minus a deduction amount. This should be a nominal amount calculated by dividing the reduced purchase price by life expectancy at date of purchase, or the date on which the deferred product becomes eligible for the pension phase earnings tax exemption, if that is a later date. This is exactly the same calculation as is currently applied for immediate non-account based pensions, such as lifetime annuities, using the Relevant Number. Since no income is received during the deferral period there is no income to assess and no deduction amount would apply or be credited.

This position recognises that an individual no longer has access to this capital during the deferral period, therefore an individual's actual means is reduced and the invested capital or premium is foregone should death occur prior to life expectancy. Once the product vests/commences an income stream, both the asset and income value can be captured by the means with a consistent methodology which currently applies to lifetime annuities.

Recommendation: The means test treatment of non-commutable, deferred products, that meet the capital access schedule, should be asset tested using reduced purchase price from the date of purchase, or the date on which the deferred product becomes eligible for the pension phase earnings tax exemption, if that is a later date. The income test for deferred products should be the income received in each year minus a deduction amount; since no income is received during the deferral period there is no income to assess and no deduction amount would apply or be credited.

3. Question 5 – Deferral period

While not entirely clear, the discussion paper implies that the value of the death benefits component (payable to the estate) should be included in the assets test during the deferral period.

It is our view that death benefits are very clearly an insurance benefit and that to ensure consistency with an unbundled arrangement (where the death benefit is insured separately to the deferred income stream), the value of the death benefit insurance should be excluded from the assets test.

4. Question 6 – Actuarial assessment

The Government made a policy announcement when it responded to the Financial System Inquiry that it would facilitate superannuation trustees offering CIPRs to their members. In December 2016 it issued a discussion paper; Development of the framework for Comprehensive Income Products for Retirement. These are composite or hybrid income stream products combining the elements of an account-based pension and a lifetime product.

CIPRs could combine separate components, an account-based pension, a group self-annuity and a traditional lifetime annuity which, without a policy change, would each be subject to their current means test treatments. The implication of valuing the hybrid using an actuarial or net present value (NPV) approach is that the means testing of the lifetime annuity component would become significantly more onerous than the current treatment for a lifetime annuity and the current treatment of an account based pension.

The current means test treatment of lifetime annuities, both the income and assets tests, most closely simulates the characteristics of lifetime annuities and therefore the means of holders of them. The average Age Pension outcomes, when considered on a pooled basis, provide neutrality with account based pensions.

An actuarial approach would ascribe a discounted value to each expected cash flow based on its nominal value and the probability of the retiree surviving to receive it. This does not take sufficient account of the insurance characteristics of lifetime products, whereby capital that had been subscribed by those who die early remains in the pool to pay the incomes of those who die later. In contrast account based pensions do not function in the same way and the remaining capital of those who die before their account is reduced to zero leaves the superannuation system as a bequest. It should also be noted that no matter at what age the retiree dies the NPV of the lifetime annuity always assumes more years of life, and therefore income, than the retiree actually receives.

Using an actuarial approach to means test a hybrid CIPR would result in Age Pension outcomes that are worse than if the constituent parts were assessed separately under current rules. This would also result in CIPRs being means tested more harshly than a stand-alone account-based pension. That would discourage acceptance of CIPRs.

Lack of neutrality and the consequent likelihood that an actuarial approach would discourage acceptance of CIPRs has a bearing on its performance against the other five means test principles:

- Equity, defined as horizontal equity, is highly dependent on neutrality, so the actuarial approach performs poorly against this principle.
- Resilience is defined as the ability of the means test to be applied to new products without diminishing equity or neutrality. Given that the actuarial approach diminishes both neutrality and equity it also performs poorly against this principle.

- Integrity is defined as targeting Age Pension income support to those who need support and circumventing strategies to minimise means test assessments. The actuarial approach performs poorly against the targeting criteria because it would discourage use of longevity protection by those who need it. Since these products are currently neutrally treated and provide lifetime income, discouraging their use is likely to diminish rather than enhance integrity.
- Fiscal sustainability is defined as reducing the cost of the social security system. Lifetime products improve long term fiscal sustainability by increasing the amount of income from superannuation available to be means tested. This will have most fiscal impact late in life. An actuarial approach, by discouraging use of lifetime products, will result in less sustainable superannuation income streams and more unintended bequests thus reducing fiscal sustainability.
- Simplicity is defined as rules that are easy to understand and which support people to make good decisions. An NPV would be difficult for all but the most financially literate retirees to understand or for financial advisers to explain. In the absence of mandated rules, which would be likely to be only appropriate generally but not to specific products, an actuarial approach would be complex for funds to manage. As it would discourage the use of longevity insurance it would not support good decisions.

The emergence of hybrid and complex products other than CIPRs is probable. If these offer flexibility in terms of the income stream they provide they will need to comply with the capital access schedule so that they will not be required to comply with the minimum drawdown rules. That being the case, the consistency of the capital access schedule with the current means test rules for pooled longevity products (such as annuities and GSAs) suggests that the current means test arrangements will prove to be a simple and robust for most hybrids and complex products.

If hybrids have more substantial liquidity features or death benefits they should be subject to the minimum drawdown requirement to qualify for the pension phase earnings and benefits tax exemptions and be means tested in the same way as account based pensions.

Recommendation: The FSC supports variable treatment based on the component features of the product.

5. Question 7 – Assessing individual components

Means testing hybrid, composite and complex products would be better achieved on a look through basis to the individual components rather than using an actuarial approach because it would maintain neutrality of treatment under the current rules with stand-alone products. This would be the case whether they be pooled longevity products, term annuities or account based pensions.

By not altering the current relative neutrality of the treatment of products it would not result in either under-use or over-use of any product type. Government policy is to facilitate the use of composite products through CIPRs because no single product has been developed which has the characteristics and reliability that will manage risk and fulfil all a retiree's needs.

Providing both the current set of rules for stand-alone products and an alternative actuarial approach for hybrid, composite or complex products would create opportunities for regulatory arbitrage between one regime and the other simply by separating or combining products. That kind of activity is the opposite of what is required to achieve neutrality, efficiency and optimal retirement income and social security outcomes.

There may be cases where hybrid and complex products have features which interact with judgment being required to determine the economic substance. It is less likely that this will be a problem where the provider has built a hybrid or complex product that conforms with the capital access schedule. Hybrid or complex products are more likely to be difficult to assess under the current regimes for both account based pensions and pooled longevity products. Those that are difficult to assess could be dealt with by use of a determination process and binding advice discussed under Question 8.

It is a given that new products will from time to time result in a substantial threat to the integrity of the system. A timely policy response based on previously announced principles is the appropriate antidote for this, not a vaccine that kills all innovation.

Recommendation: Means testing composite and complex products would be better achieved on a look through basis to the individual components rather than using an actuarial approach.

6. Question 8 and 9 - Determination process

Question 8 considers whether a DSS determination process would be necessary or useful to enable the development of income stream products.

The FSC notes that any such DSS determination process may be in addition to existing APRA oversight of superannuation and insurance products, and a potential additional approval process contemplated in the ongoing Treasury consultation around MyRetirement products.

Regulatory approval before any product can come to market inherently has a dampening effect on product innovation. The FSC recognises that it may be necessary for consumer protection purposes to have a determination or approval process for financial products, but supports such a process being as simple and efficient as possible.

In this context the FSC recommends that DSS not impose a mandatory determination process for income stream product. The FSC recommends that, similar to ATO determinations, DSS enable providers to consult with DSS around product design and have the option of seeking a determination on a voluntary basis.

The FSC envisages that this optional approach will encourage industry consultation with DSS early in product development processes and will also enable superannuation funds and insurers to more effectively manage their product development stages across DSS and APRA.

Recommendation: Consultation between DSS and product providers during product development phase and offer providers an optional determination process that is similar to ATO rulings.

7. Question 10 – Definitions

The FSC is concerned that there is inconsistency in definitions relating to superannuation and insurance products across social security, superannuation and tax legislation.

The FSC recommends that, as part of an ongoing effort to improve the consistency and efficiency of regulation, definitions and language in the *Superannuation Industry (Supervision) Act 1993* be used to underpin reforms in this policy area.

Recommendation: Legislation uses definitions and language in the SIS Act to underpin future reforms.

8. Question 11

The DSS paper contemplates the product innovation that will likely occur in the retirement income stream market over the medium term. The FSC appreciates this 'future proofing' approach to policy development taken by the DSS.

At this point in time the industry focus is on the FSI recommendation to develop products that provide an income stream in retirement. This alone will be a significant improvement on the status quo as it will allow consumers to better manage risks associated with retirement.

The FSC is of the view that the first stage should be to implement a flexible framework that allows product development and innovation over time, as is contemplated in this submission. This will ensure that, whilst products may not immediately incorporate issues such as residential aged care, the system will not require significant overhaul to include such features into the future.

Recommendation: The DSS implement the framework outlined in this submission that is sufficiently flexible to first ensure the Government's stated policy is a success, and sufficiently flexible to enable innovation into the future.

9. Submission on alternative means test arrangements for pooled longevity products

An important principle is that all pooled longevity products, whether they be lifetime annuities (standard or variable) or group self-annuities are treated in the same way. In each case, there is a pooling of the longevity risk so that the actual return to individual investor is unknown and there may be no capital on the death of the investor.

The FSC also wishes to make submissions on alternative means test arrangements on pooled longevity products (such as annuities and GSAs) that the FSC does not support as they are inconsistent with the Government's policy to facilitate the introduction of retirement income stream products and MyRetirement products. This information is relevant to question two in the discussion paper, but the FSC has included it later in our submission so as to provide greater detail on issues that arise in relation to alternative options.

In particular, the Discussion Paper asserts at paragraph 25 that the current means testing arrangements for annuities are concessional compared to other products. The basis for this assertion seems to be that:

- The assets test treatment of a lifetime annuity and a term annuity to life expectancy are identical and cease at life expectancy when the reduced purchase price is zero;
- An account based pension drawn down at minimum rates will continue to have an asset value after life expectancy; and
- While assets tested lifetime annuitants would not have their Age Pension reduced after life expectancy income tested annuitants would.

The three products performance is presented graphically in Chart 1, together with the assumptions that have been used.

None of the described comparisons prove that a lifetime annuity receives concessional treatment because they are not like for like comparisons:

- A lifetime annuity is a pooled product. In the example described a person who dies early does not get the benefit of all the capital they have paid as a premium. Instead that capital is

used to pay the incomes of those with longer lives. The fixed term annuity does not result in a similar loss of capital in the event of an early death. In that case the remainder is paid to the estate.

- Where the holder of an account based pension survives passed life expectancy and the account based pension doesn't fail it will have an asset value that may have an effect on Age Pension entitlement. If the retiree dies before the account based pension fails the residual will be paid to the estate as a death benefit. A lifetime annuity will not have an asset value after life expectancy because the annuitant will receive no death when they die and the annuity payments that they continue to receive while they survive are funded from the pool of capital left by those who died early.
- The differences between the treatment of assets tested retirees and income tested retirees after life expectancy go to a more complex set of issues around the interaction of the income and assets tests, Given retirees typically only commit a minority of their starting balance to an annuity, these differences in treatment are likely to be driven by the existence of other income and assets which go to the question of vertical equity rather than the asserted concessional treatment of a lifetime annuity.

Having regard to their characteristics the current treatment of lifetime annuities and account based pensions is considered by the industry to be neutral. If the treatment of lifetime annuities were concessional it would be reasonable to assume that sales of these products would be driven by the concession, which was the case when there was an assets test exemption (ATE).

With the re-emergence of the lifetime annuity market in Australia, after the loss of the ATE, growth in sales are now based on the characteristics of the product which include a lifetime income stream guaranteed against market risk and, if the retiree chooses, protection against inflation. The principal inhibitor of growth in the sale of these products is the well documented behavioural biases of retirees.

Having asserted, but certainly not demonstrated, that lifetime annuities receive concessional means test treatment, the Discussion Paper proposes six possible policy changes to means test them more heavily. Before discussing each of these it is important to consider how the current treatment operates so that it can be used as a benchmark.

Unlike account based pensions and financial assets with similar characteristics that can be assessed on an individual basis, lifetime annuities are pooled products and need to be assessed on a pooled basis. Both the costs and benefits of payments from the pool and their social security treatment are shared on the basis of individuals' longevity. Short lives get less, long lives get more but the system is fair on average based around the fulcrum of life expectancy.

The mechanism for achieving this redistribution is the notional straight line reduction in asset value from purchase price to zero at life expectancy for the assets test and deduction amounts for the income test. Both are important in achieving the necessary redistribution and neutrality with account based pensions. This submission proposes that the life tables used to calculate life expectancy should be updated to include the Australian Government Actuary's (AGA) 25 year mortality improvements. Apart from that, the FSC contends that the current arrangements are fair, equitable and an appropriate basis for the means test treatment of the new category of longevity products which was legislated in November 2016.

How do the six proposals for policy change compare with the current treatment as a benchmark?

1. Extend straight line to age 90, 95 or 100

The first proposal would extend the current straight line to a specific later age, either 90, 95 or 100 years. One age would replace the current Relevant Number which is based on age cohort life expectancies. Age cohort life expectancy is the number of years a person who has reached a particular age can expect to live for.

For a 65 year old, extending the straight line to 90 years is quite similar to using the life table with AGA 25 year mortality improvements. However it will result in less equitable treatment for those who make a quite rational decision to buy a lifetime annuity late in life. For those approaching 90 years, the closer they are to it the lower the reduced purchase price and the higher the deduction amount. For the small number who buy a lifetime annuity after 90 years, this does happen, if asset tested they would presumably be exempt, and if income tested they would have no deduction amount. This is an anomalous pair of outcomes. The same problems would occur around 95 and 100 years if either of those dates were selected but for a smaller group of retirees.

The fundamental problem with moving the straight line out to 95 or 100 years in an attempt to test more of the means of those who live longer is that it removes the balance of the pooling of the means test around life expectancy and means tests everybody more heavily. It also removes the synchronisation of the means test with the way the product works and with the tax treatment of non-superannuation lifetime annuities, as well as the SIS pension rules for the new category of lifetime products. The heavier means test treatment will discourage the use of products to manage longevity and the de-synchronisation of SIS, tax and social security treatments will add to complexity.

2. Formula providing reverse of the tax depreciation schedule

The second proposal would replace the straight line by a formula providing the reverse of the tax depreciation schedule out to a nominated age n. This is depicted in Chart 2 of the Discussion Paper where n equals age 100. Paragraph 33 says the rationale for this policy change is that the straight line rule for reduction of the purchase price might also be considered concessional because *"a stream of payments from a financial investment may, in general, be expected to return modest amounts of capital in the early stages, with an increasing proportion of payments consisting of the return of capital (and the longevity dividends) as the earning potential of the initial investment decreases over time."*

This is completely misconceived. It seeks to treat the lifetime annuity as a pure investment product and to capture all of the deterministically calculated upside, including mortality credits, without any offset for the very high costs paid by those who die early. It too is an attempt to test more of the means of those who live longer and would result in much heavier asset testing than extending the straight line to the equivalent of year n. That would discourage use of longevity protection.

The proposal abandons simplicity:

- Only the most financially literate will understand the formula;
- If n is not arbitrarily determined at age 100 what would be the rationale for setting it;
- Logically deduction amounts should mirror the assets test treatment of the return of capital, starting small and growing strongly as age approaches n, which would be unlikely to help smooth retirement income.

3. Actuarial approach

The third proposal is the actuarial approach, undertaken either by calculating the net present value (NPV) of the future stream of income payments or alternately the by valuing the assets underpinning the product.

An NPV of the income stream would ascribe a discounted value to each expected cash flow based on its nominal value multiplied by the probability of the retiree surviving to receive it. This does not take sufficient account of the insurance characteristics of lifetime products, whereby capital that had been subscribed by those who die early remains in the pool to pay the incomes of those who die later. In contrast account based pensions do not function in the same way and the remaining capital of those who die before their account is reduced to zero leaves the amount remaining in the superannuation system available as a bequest. It should also be noted that no matter at what age the retiree dies the NPV of the lifetime annuity always assumes more years of life, and therefore income, than the retiree actually receives.

An NPV approach based on the assumed income stream provides for significantly heavier means testing discouraging use of lifetime products. It could be expected to render deferred lifetime annuities (DLAs) unmarketable if they were not made exempt from the asset test.

The NPV approach would only be understood by the most financially literate retirees. The outcomes would be highly sensitive to the discount rates adopted which would be technically difficult and contentious to regulate. If they were set by providers without adequate regulation even quite marginal increases would flow through into Age Pension outlays.

4. Valuing the assets underpinning a non-account based pension

The fourth proposal to means test non-account based income streams by valuing the assets underpinning the products is misconceived for lifetime annuities. First, it attempts to treat them as investment products, ignoring their fundamental insurance characteristics. Second, it fails to recognise the contractual nature of a lifetime annuity policy. The life office contracts to provide for a premium a known stream of income payments to the retiree while they are alive. Fluctuations in the value of the assets underpinning the product, which includes shareholders capital, are normal but have no bearing on the income stream and therefore the policy holder's means.

5. *Means testing death benefits*

The fifth proposal is to means test death benefits. The capital access schedule for the new category of longevity products makes specific provision for a death benefit of up to 100% of purchase price for half life expectancy. The reason for this policy is that it will overcome one of the key behavioural biases of retirees who might otherwise choose not to buy longevity protection. APRA's prudential standard on paid up and minimum surrender values (LPS 360) requires that if an annuity has a death benefit it must have a surrender value. LPS 360 ensures that such a surrender value is fair.

There is no justification for means testing death benefits where they are within the requirements of the capital access schedule. Death is a sufficiently harsh test to stop any abuse. Where death benefits exceed those permitted by the capital access schedule there could be scope for their use for estate planning purposes. In that case, since death remains a possibility but not a certainty, it would be appropriate to means test a death benefit according to the products surrender value, not the full value of the death benefit.

6. *Capping deduction amounts*

The sixth proposal is to cap deduction amounts when the Reduced Purchase Price (RPP) has reduced to zero. This is based on the rationale that there is no justification for a deduction amount after the original purchase price has been returned. That has intuitive appeal but ignore the important role which the RPP plays in redistributing the costs and benefits of the means test amongst members of the pool. Those who live passed life expectancy may receive more benefits than those who die early, however they are likely to be heavily means tested late in life because their income streams are more sustainable. The continuing deduction amounts make a significant contribution to the pooling of the benefits and without them lifetime products would be means tested on average more heavily, discouraging retirees from providing for their own longevity protection.