6 February 2017

Ms Cath Halbert
Acting Deputy Secretary
Department of Social Services

Dear Ms Halbert,

Thank you for the opportunity to comment on your Discussion Paper on means testing for income stream products. The Actuaries Institute may be replying separately to your discussion paper, but in the interim and given your time pressures, I would like to provide you with the following replies to the questions you have raised – in my personal capacity.

In summary, my preference is to subject all income stream products (with no death or termination benefits) to a single test that applies to both income and asset components of the amounts drawn down. This could be achieved by allowing for 30% to 50% of the amounts received from income stream products or termination to be included in the income test (ie reducing the Age Pension by 15% to 25% of the amounts drawn). As assets would not be available until they were withdrawn, and would all eventually be subject to this taper, the asset test would not then apply to these products. I believe that this will meet all the principles that you have raised in your Discussion Paper.

I also make some other suggestions for creating a single test that would better address the principles that you have set out.

I would welcome the opportunity to discuss the issues further. I believe that appropriately designed means tests are a critical element of the environment necessary to achieve effective retirement outcomes for more Australians.

Yours sincerely

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Discussion Paper: Social security means testing of retirement income streams

Responses to questions.

Q1. Given the shortcomings identified above, what changes should be made to improve the means test rules for existing income stream products to ensure that they meet the policy principles of neutrality, equity, resilience, integrity, fiscal sustainability and simplicity?

It is my view that the current assets test fails many of the design principles articulated in section 12 (paragraph 12) of the Discussion Paper.

Of the shortcomings noted in the Discussion Paper, I would comment additionally:

- Family homes are not really "exempt assets" as they are explicitly part of the asset test, and are included at a nominal value of $200,000 for both singles and couples. The existence of rent assistance adds a further implicit $100,000 – approximately.

- The means tests in their current format make it exceptionally difficult to plan for any particular pattern of drawdown – as the Age Pension increases with assets and income in a way that is difficult to understand and model over a retired lifetime.

In the appendices, I have produced tables showing the relative costs of the asset test, taking into account the time value of money and probabilities of survival. In Appendix 1, I have looked at the three products illustrated in Chart 1 on page 8 of the Discussion Paper for investments of $100,000, and then considered an investment outside of superannuation with no drawdown – also falling within the asset test limits.

- For an investment of $100,000 in a life annuity subject to the asset test, after taking account the loss of Age Pension, and using my assumptions, the annuitant would obtain a lifetime present value of about $42,400. In other words, this would be equivalent to the loss of 57% of their lump sum investment.

- With a term more or less equal to life expectancy, term annuities are comparable. While the term annuitant does not get the "asset test free" period after the end of the term, their heirs get the money back earlier. Term annuities would give a higher return for shorter periods as they are less subject to the asset test. The rate of interest makes little difference to the comparison.

- An account-based income stream with a minimum drawdown fairs much worse, the $100,000 producing only $14,500 value for pensioner and heirs together. This is because the drawdowns are low and there is a long period where the net benefit is negative.

- All of these do, however, compare favourably with holding the assets outside of superannuation and only drawing investment income. Here the net loss is $158,000 to the pensioner who survives to 100 (i.e. the pensioner loses $158,000 by keeping the $100,000 and not spending it), while the total net present value of the *loss* to pensioner and heirs is $11,000 (i.e. over and above the $100,000 investment).

There is therefore a strong incentive to draw down quickly or move assets into the family home. Research suggests that retirees do both[1]. While only 19% of couple pensioners are subject to the asset test[2], rough calculations suggest that over a third of those over 65 should be in this category[3]. An analysis of Centrelink data suggested that those pensioners subject to the asset test draw down their assets up to 10% faster. [4]

Figure 1 below illustrates the problem simply. It applies at any one time, and would apply over a lifetime to someone who only spent their investment income and who was earning a real rate of interest of 3% and another earning 5%. The latter could represent a life annuity and the graph would also apply throughout life. The asset test creates a trough in income between about $300,000 and $700,000 in assessable assets.

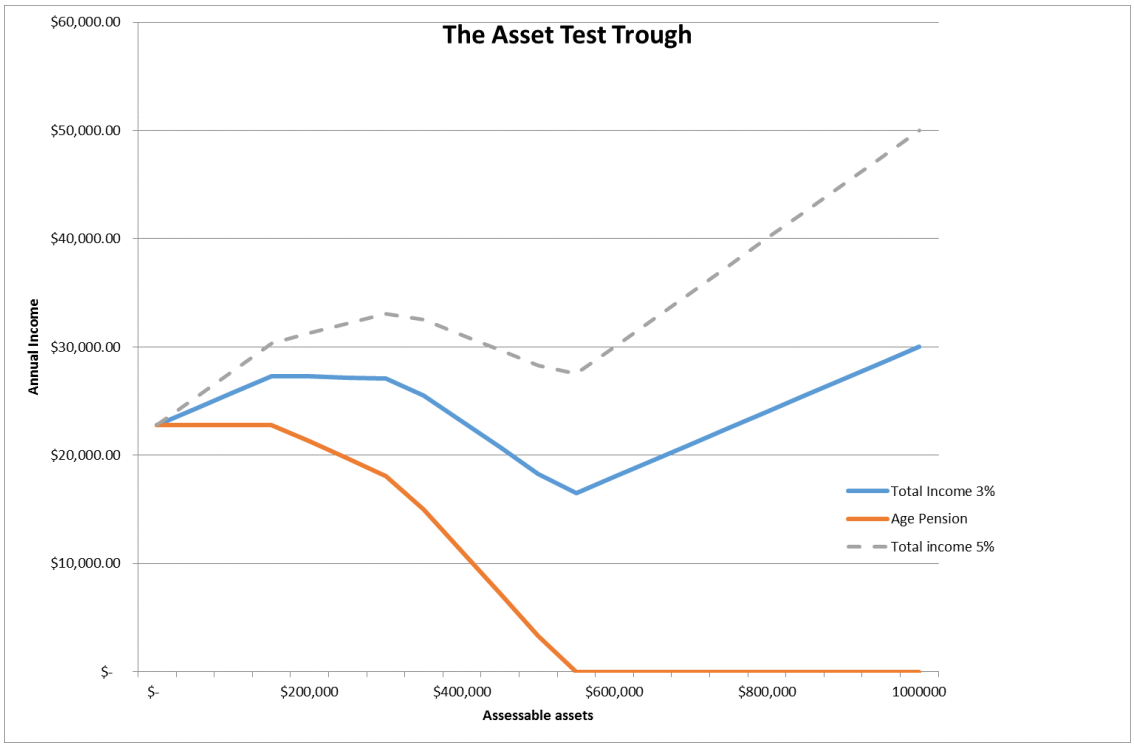

Figure 1 For those who retain assets

The calculations above are based on the marginal effects, and do not consider the consequences if the pensioner later falls below the limits. A more complete picture may be obtained by considering the average impact over a lifetime, using various drawdown strategies.

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[1] Sane, R. and Piggott, J., 2008, October. Does the Owner-Occupier Exemption from the Pensions Means Test Affect Housing Choice of the Elderly? Evidence from Australia.

Bradbury, B., 2010. Asset rich, but income poor: Australian housing wealth and retirement in an international context. FaHCSIA Social Policy Research Paper, (41).

[2] Department of social Service Statistical Overview 2013

[3] ABS 6554 (2012) reports median net worth of $730,000 for those of 65 and home values of $398,000 for the population, meaning that those on the median are well above the asset test free limit of $273,000 of that year. Those at the top of the 80th percentile have assets of $1.5 m, but deducting homes of more than $500,000 means that they too should be captured.

[4]www.cepar.edu.au/media/154967/age_pensioner_profiles_a_longitudinal_study_of_income__assets_and_decumulation.pdf

Appendix 2 therefore considers various strategies that a single homeowner might take. I have assumed assets exactly equal to the top of the asset test level, which produces the largest impact – for illustration purposes.

Figure 2 below shows the lifetime effects (until age 100) of the various strategies described below.

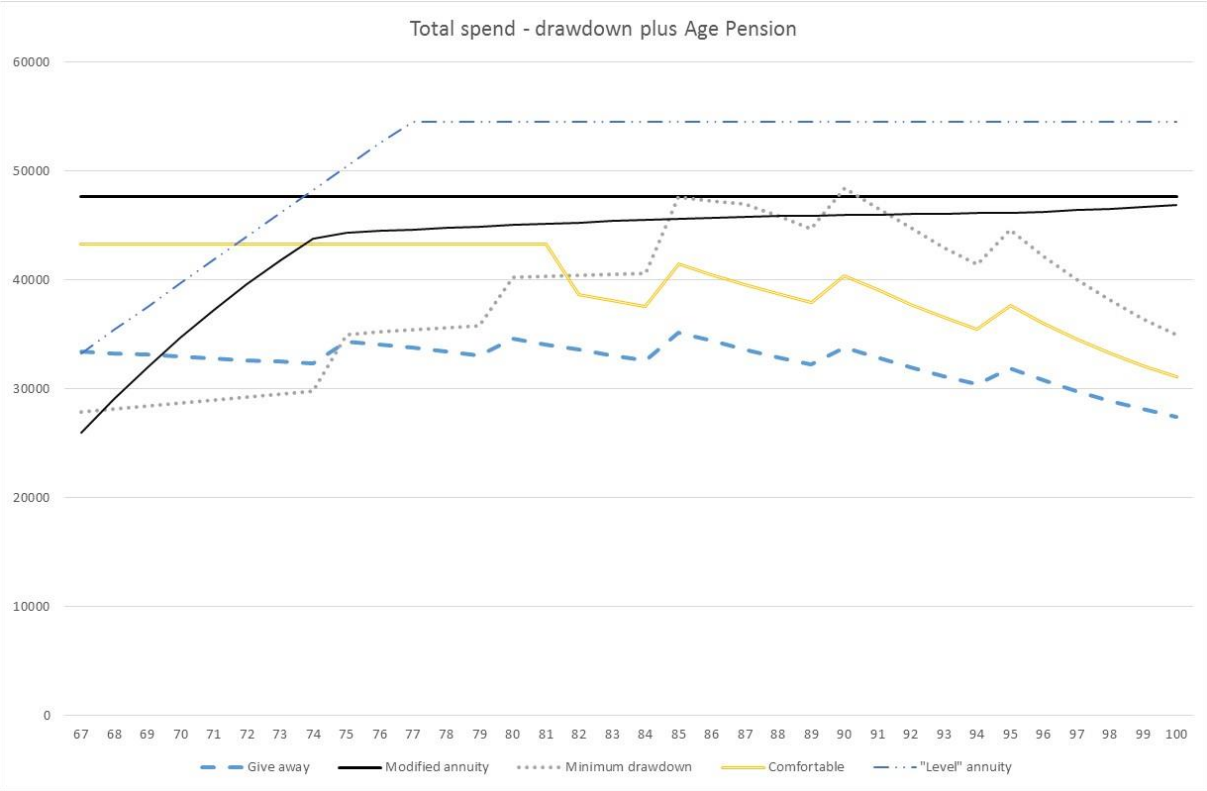


Figure 2 Alternative retirement consumption patterns

- If she draws down the minimum permitted by pension regulations, the value of her assets at the beginning of retirement are shared in roughly equal thirds: one to herself, one to her heirs, and one in fiscal savings. Her spending is shown as the dotted *Minimum drawdown* line in Figure 2. This is the strategy I understand is adopted by some 50% of pensioners – although it is a lower percentage for those subject to the tapers.
- If at 62, she gives away enough of her assets to escape the asset test altogether, her share drops slightly to 30%, fiscal savings drop to 22% (via the income test)), while the heirs obtain 69% - $260,000 immediately. This is the most fiscally efficient for the pensioner and family – and is illustrated by the dashed *Give away* line. Rather than given away, the money can be invested in the family home – or spent before pension age – which would allow the pensioner to directly enjoy 98% of her savings.
- Another alternative is for the pensioner to spend the money after retirement. Strategies that I understand are recommended by advisors are to draw enough money to maintain the ASFA comfortable lifestyle for as long as possible. Appendix 2.3 shows that her share would then rise to a little over 50%, with her heirs and fiscal savings sharing the balance. This is shown in the *Comfortable* line in Figure 2.

- A "level" annuity throughout life produces a rising Age Pension as shown in Figure 2. A final alternative therefore incorporates a level annuity plus an allocated pension that together produce a level spending pattern in retirement. The total income and the amount provided by the annuity plus Age Pension is shown by the unbroken *Modified annuity* lines. The present value is shared 71% to the pensioner, 1% to the heirs (from the allocated pension) and 28% in fiscal savings. This can be compared with the allocation that would have occurred if the asset test was based on actual liabilities rather than the "concessional" treatment afforded annuities. The optimal approach there would yield 60% of the value to the pensioner and 40% to fiscal savings – and nothing to the heirs. Detailed calculations for these options are not shown in the appendix.

While the results will vary significantly depending on the underlying assumptions, one can draw three conclusions from these calculations:

1. Pensioners are penalised, and greater fiscal savings accrue, the longer they hold onto their assets.
2. The penalties can be reduced by giving money directly to heirs, spending the money faster, and especially investing in the family home. These actions are therefore incentivised.
3. There are very significant gains that can be made by adopting different strategies. Determining an optimal strategy is however complex for pensioners, made more difficult by ongoing changes in the means test rules. Forecasting is also difficult for government as pensioners change their strategies in reaction to the incentives.

Measured against the criteria, I would identify the following issues.

Neutrality

The differences in treatment for different products and funding methods generally arise from different spending patterns rather than just the issuer/legal structure. Annuities do enjoy relatively favourable treatment relative to the actuarial determination of asset values. I estimate that fiscal savings fall from 71% to 58% of the initial investment – at the margin. Currently, deferred annuities and some group self-annuitisation (GSA) and other variable annuity type contracts are either not permitted or can be difficult to fit within a superannuation fund.

There are however significant differences between investing money in the home and alternative investments – and having younger members of the family hold assets.

Equity

I suggest that there are significant related inequities arising from the current system.

- Horizontal inequity arises for people with the same level of wealth (which is at one level fungible). Non-homeowners with $1 million in assets will get no Age Pension, while homeowners with a house of that value will draw the whole Age Pension. The same applies to those with grandfathered exempt assets, compared with those who have recently lost the Age Pensions as a consequence to changes in limits, who have not been grandfathered. (I am not suggesting that grandfathering is necessarily equitable, just that equity requires consistency.)
- Vertical inequity arises when the differences in treatment applied to people are not proportional to the differences in their characteristics.
- The dramatically higher taper applied by the asset test does not seem proportionate, neither does the failure to differentiate between those with valuable houses and those with small apartments. I believe that these inequities could be relatively easily addressed together to achieve fiscal neutrality.

- The means tests fail to address real differences that arise from different life expectancy. Most important is that they penalise younger retirees at the expense of older ones. A couple of 67 with $1 million in assets and investment income of $50,000 cannot afford the ASFA comfortable retirement. A couple of 90 in the same position could comfortably spend $100,000 pa, well above the comfortable level.
- Women also need more than men to maintain the same spending given their greater expected longevity. Arguably the assets tests are discriminatory as they advantage men (who require less) than women.
- My recommendation to base the tests on amounts drawn from income streams with no death or commutation benefits would address issues for these products.
- I also note that regional differences in rent and the cost of living also create vertical inequities, but these have no obvious solutions and are therefore easier to justify.

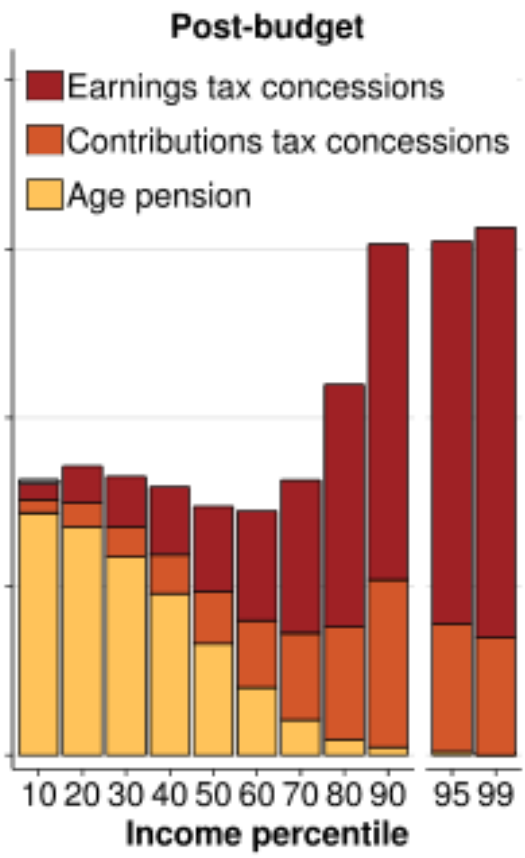
The current tests also fail the test of justice, because it is possible to significantly reduce their impact. This benefits those who are able to obtain appropriate advice and are sufficiently flexible to act on the advice. Their complexity however makes it very difficult to make the right decisions. This means that the costs are borne by the less well informed, the cautious, and possibly by those who regard it as anti-social or degrading to be supported by welfare[5]. The frequency and extent of changes both illustrates and contributes to lack of justice.

Integrity

I understand this to mean the extent to which the means tests integrate with other policy objectives, particularly of the superannuation system and the tax system.

As discussed above, we do think that the means tests integrate rather poorly with the superannuation system because of the complexity involved in planning a sensible spending pattern through retirement.

The Treasury graph from the 2016 budget papers shows that the net impact of the means tests and tax concesssions is to penalise the middle income deciles relative to both higher and lower deciles. The "U-shape" is, in fact, even more pronounced as Treasury assumed a pension eligibility age of 70 (which has not yet been legislated) and a relatively high disciount rate of 5%. This is another illustration of the "asset test trough" shown above. I believe that it would be preferable to attempt to integrate the rules in such a way that additional superannuation savings always produces an improvement in post retirement.



[5] We are not aware Australian evidence, but stigma apparently explains lower take up rates of pension in the UK https://www.pensionspolicyinstitute.org.uk/uploaded/documents/PPI_Nuffield_seminar_5_main_paper_Nov05.pdf

Resilience and fiscal sustainability

I would suggest that it should be possible to obtain the desired level of fiscal expenditures by fine tuning the size of the Age Pension and the parameters governing the means tests. This is made much more difficult by the exclusion of the value of the family home, and a high taper rate that mean fewer people are affected by changes. These principles are also undermined when significant numbers of people can increase their benefits by acting on appropriate advice.

Simplicity

Appendix 2.4 shows the impact of removing the asset test on the strategy illustrated in appendix 2.3. I include it to show that it does have a significant impact on the value of the pension, although obviously not as large as the asset test. The asset and income tests could be simplified if they were combined. Such simplification would also make anomalies easier to identify, and eliminate, as in the table below:

MEANS TEST (SINGLE)

	Current	Possible alternative
Deeming rates		
Assets up to $49,200*	1.75%	3.25%
Assets up to $309,814*	3.25%	3.25%
Assets over $309,814*	15.6%	6% (say)
Home	$200,000 if assets over $250,000	Included at Surveyor General values – with deemed returns, and with a threshold of perhaps $2 m.
Physical assets	Exempt if financial assets less than $309,814	Exempt up to $50,000?
Rent assistance	Separate allowance	Incorporated in basic pension

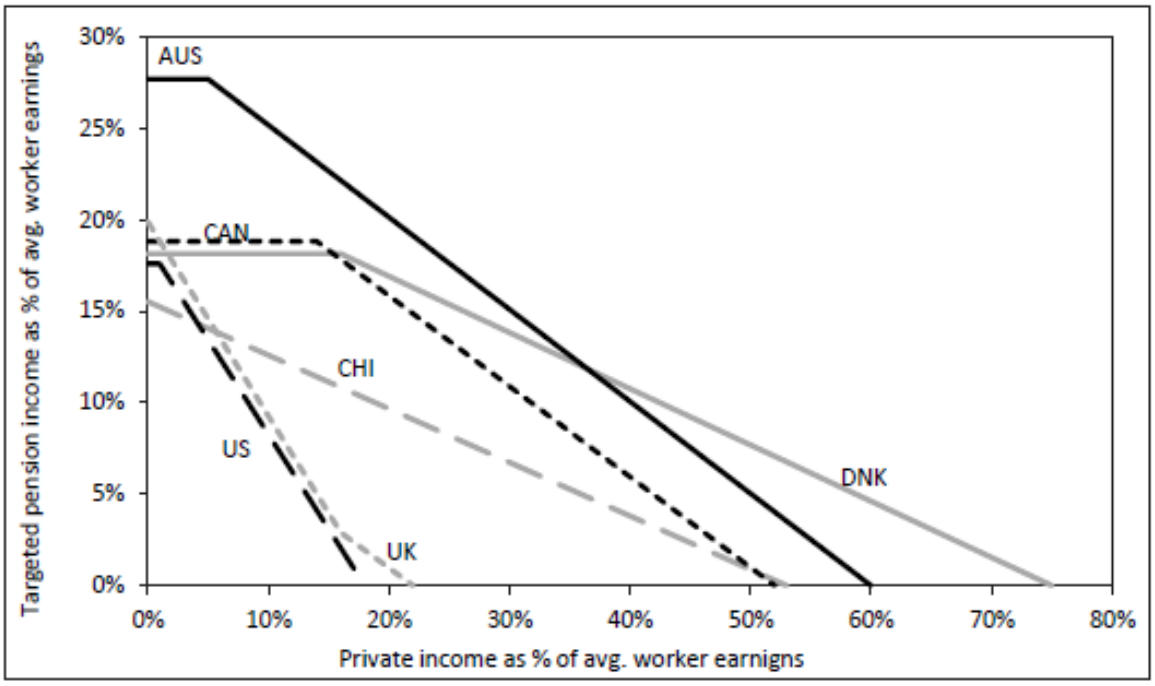
The starred limits could be adjusted to provide fiscal balance. Married rates would all be set at 50% more for the couple combined.

The current level of 15.6% is based on the rate that would apply to obtain the current level of 7.8% ($3 per $1000 per fortnight). 6% is perhaps the highest real rate of return that one might expect on assets. Anything more is penal.

The threshold on the value of the house could be justified as allowing for regional differences in house prices. [6]

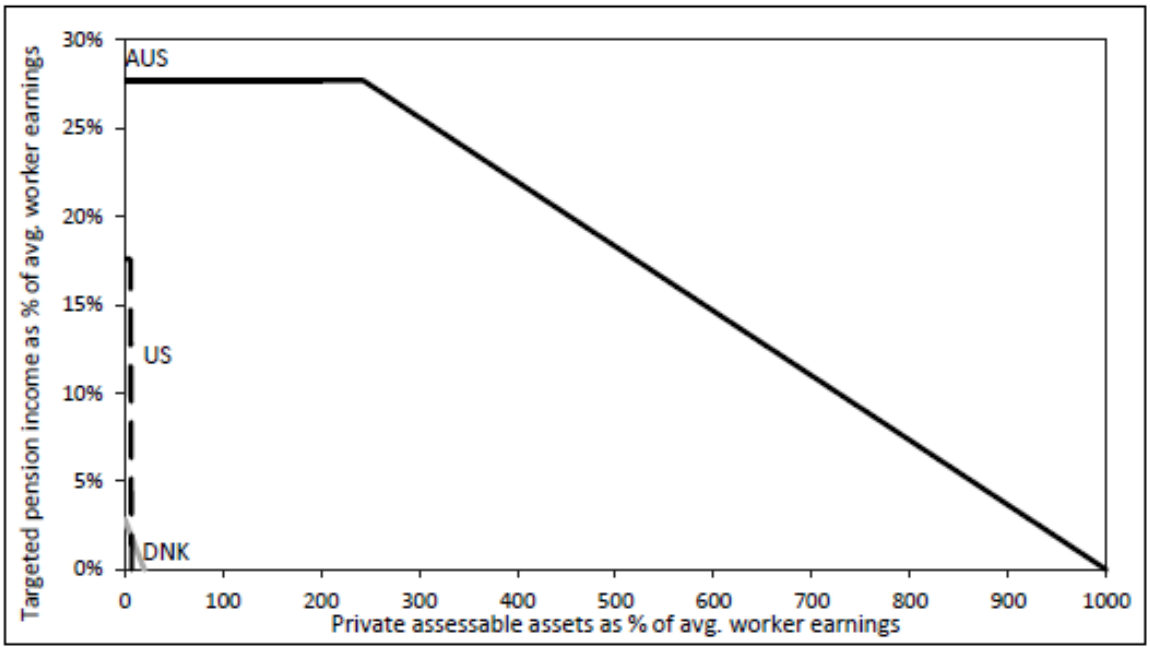
[6] http://www.cepar.edu.au/media/167089/means-testing-social-security-modelling-and-policy-analysis.pdf

Figure 3. Design of income test, Selected OECD countries, 2012-2014



Note: Avg. worker earnings: full-time adult total gross wages before deductions, including overtime and employee cash supplements); Based on single pensioner; In Chile, the test is against pension income only, but requires passing 'technical targeting instrument', a formula based on assets, income, earning capacity, and degree of child dependence. In Canada there are two types of means tested pensions: Guarantee Income Supplement (shown here) and a basic pension, which is income tested and withdrawn at a taper of 15% beyond about 150% of average earnings. Source: Authors' compilation based on country sources and OECD (2013).

Figure 4. Design of asset test, Selected OECD countries, 2012-2014



Note: Based on single (home-owning) pensioner. In Australia, assessable assets exclude owner occupied housing. In Denmark, two means tested pension elements exist, one is income tested, the other is asset tested. Source: Authors' compilation based on country sources and OECD (2013).

The Australian means tests appear to be particularly complex and affects more people than other countries. The two graphs on the previous page[7], show that the Age Pension is the highest proportion of average wages, and with two means tests affects many more people. I also understand that Australia is unique in that other countries apply the asset test only once at retirement.

The Discussion Paper states that the current assets test treatment for annuities is "quite concessional" compared to other products and also that they are "highly concessional" beyond life expectancy. While they may be less penal, for those people who do not reach life expectancy, the test penalises the heirs by more than the pensioner's gain. I also note that beyond the life expectancy, the income test (not that assets test) can come into play.

In summary, the asset test is especially unfair on the cautious who retain assets for precautionary purposes; makes planning extremely difficult; and significantly distorts the investment and drawdown behaviour of many retirees. It fails all the policy principles except possibly that of fiscal sustainability, but there are numerous alternative approaches that could be made fiscally sustainable.

Q2. What changes, if any, are necessary to ensure a sound foundation for new rules to assess innovative income streams?

My preferred view is that, ultimately, the assets test should be abolished and instead the DSS should rely on the income test alone – with revised deeming rules applying and possibly a higher rate as in the table above.

The main difficulty is created by point 3 on page above: given that the impact of the means test on the different parties differs so considerably, there is no benchmark against which to measure the principles.

I believe that a sound foundation would provide a simple means to spread superannuation savings evenly over the remaining lifetime, and create disincentives to spending assets too quickly or leaving it all to heirs. I suggest therefore that pure life annuities should provide the benchmark because they spread income over the lifetime exactly, and nothing is left to heirs.

I agree that bequests should be discouraged in policy settings. Increasing expenditure by pensioners rather than heirs brings forward economic growth. Greater expenditure by pensioners means a more optimal retirement and overall a better lifestyle. An enhanced lifestyle also leads to improved long term health. A healthier retiree population would directly lead to a reduction in the health care and medical financial burden on the State. More than this, we move closer to the ultimate goal of ensuring an adequate, enriching and sustainable retirement experience for retirees.

The simplified method of applying the income test to annuities (i.e. dividing each the payments in constant proportions – one which represents income and the other return of capital) is elegant and allows for easy planning: the amounts clawed back from the Age Pension are constant over time. It would be possible to apply a different taper rates to the income and capital proportions as necessary for fiscal sustainability.

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[7] Taken from Chomik, R., Piggott, J., Woodland, A.D., Kudrna, G. and Kumru, C.S., 2015. Means testing social security: Modelling and policy analysis.

My recommendation is to move to an income test that tapers the Age Pension payable by a proportion of the amount withdrawn from superannuation – for income streams offering no surrenders or death benefits. The other elements of the means tests can be left unchanged in the short run.

Given the current low interest rates, guaranteed annuities today have a minimal interest proportion – low enough to be ignored. As shown above (in Figure 2 and description), the asset test can reduce the present value of private assets payouts from between .7% to 40% for someone at the top of the asset test limit. This equates to marginal losses of between 1% and 80% of the assets above the lower limit to which the asset test applies. This is clearly penal, and I would suggest that, even under current circumstances, a lower rate could be justified in that, by reducing disincentives, would encourage pensioners to take longevity protection such as annuities and GSAs. I would suggest 15% to 25% as a starting point that might in the long run prove neutral.

The suggestion would therefore relate to all withdrawals from pension accounts with no death or commutation benefits. For singles, the first $12,500 withdrawn from pension accounts would be exempt from the means test, but the Age Pension be reduced by 20% of all other amounts withdrawn. This would make it very easy to plan, defer and accelerate expenditure. The $12,500 would be reduced by 5% of assets outside the pension account.

This approach could be applied to all assets in due course, although would be more complicated.

I accept that there would be a short term fiscal costs, but it will take some time before these products become popular. The longer term costs are likely to be neutral given that there would be less incentive to avoid the asset test. There is plenty of scope to recover some costs by including more of the home in the asset test.

Determination of annuity values for asset test purposes

To the extent that the asset test is retained, I make the following observations that are likely to apply to innovative income streams as well.

Actuarial values could be used wherever necessary because they are necessarily calculated by insurers or superannuation funds, and providing them to members and Centrelink is a relatively simple administrative task. The major additional work will involve checking their accuracy, which can be regarded as much as a benefit as a cost as it will contribute to more accurate records.

I note that however the income is determined there will be inconsistencies:

- If the basis is updated each year, it will mean changes to asset values without a change in the pensioners' income. If they are not updated, the market values would be inconsistent with the income test.
- If each insurer uses a different basis, then incomes will be different for the customers of each insurer. If a standard basis is used, then there will be inconsistencies between the deemed asset values and the premiums paid.

The current method is simple, does not need to be changed over time and is consistent with the premiums paid. I am therefore in favour of retaining the current method and note that it could be made more penal by adding to current life expectancies. I support 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. I do not support any approach to the capital reduction (whether straight line or otherwise) that runs down capital beyond a person's life expectancy age. The approach in paragraph 37 shows reductions to age 100. My calculations (using the modified annuity approach discussed above), would make the asset and income test as penal as the minimum drawdown: the pensioner would obtain only 67% of the value of her initial assets. I regard this as excessively penal given that the pensioner has no access to capital and the heirs are getting nothing.

Q3. What approach to income and assets testing income streams during the deferral period would best meet the policy principles of neutrality, equity, resilience, integrity, fiscal sustainability and simplicity?

My answer to this question assumes that the asset test is retained. If so, there are strong arguments for excluding non-commutable deferred income streams from the means tests during the deferral period. This was acknowledged by the Henry Tax Review (AFTS section A2–3): "given the unique nature of deferred annuities, there is a case that they should only be means tested when they start to pay an income, unless a person can access the capital before this time."

There are two key issues that make deferred income streams unique:

1. No access to capital / income.

The principle inherent in the Social Security Law is that where there is no access to capital, the asset is excluded from the assets test. For example the value of superannuation assets are not included when considering the assets test for any social security benefits (including NewStart and Disability Support Pension) unless the person is of Age Pension eligibility age.

Deferred income streams provide no access to capital or income during the deferral period and consistent with this approach should be excluded.

Including the value of a deferred income stream in the assets test during to the deferral period may lead to unintended outcomes. Consider an extreme example - it is possible that a person could have their Age Pension reduced even they have no income or no accessible assets (if their only asset was a deferred income stream in the deferral phase).

My calculations – shown in Appendix 3 – that it would be particularly penal to include the value of the deferred annuity in the asset test prior to vesting. I have assumed a $20,000 investment in a deferred annuity subject to the asset test, and that the value was based on market values. On this stand-alone basis, there would be a negative $10,000 net present value. Exempting the product from the asset test prior to vesting would give a value of $16,000, which still involves the loss of 20% of the investment. Basing the value on the initial purchase price is also shown. The net present value remains negative unless the annuity is exempt pre-vesting, but reduces to only $9,000 if it is exempted from the asset test pre-vesting. This is because the income proportion of the annuity is increased.

2. Contingent / Insurance nature of product - testing for a benefit that may not arise

In Social Security Law the contingent proceeds of insurance (including life insurance) are not included in the assets test until the benefits are actually received. The surrender values are included, but they are frequently considerably lower in value than the present value of the benefits. (Special arrangements are also made for funeral insurance). Deferred income stream products are a type of insurance providing insurance in the event of long life and should be treated consistent with this category – if there are no death or commutation benefits.

Fiscal Sustainability

Exempting deferred annuities from the asset test in early years would have the impact of reducing the penalty. Combining a deferred income stream with an account based pension product will lead to a slightly higher Age Pension payment at younger ages if the deferred income stream is exempt during the deferral phase. It will however also lead to lower Age Pension payments at older ages when included in the means tests.

I have done further calculations to illustrate the overall impact. Comparing a life annuity with a term annuity of 17 years and a deferred annuity starting at 85 (for a $100,000 package all subject to the asset test taper) and I find that the fiscal savings reduce from 58% to 51% of the initial value. This would clearly make deferred annuities more attractive than immediate annuities, but given that retirees would be unlikely to put more than 20% of their assets into a deferred annuity (my calculations were for 15% to produce equal cash flows), the impact is likely to be small.

The more holistic approach for a single homeowner at the top of the asset taper, the fiscal savings decline from 25% to 16% of her initial assets. It would be possible to include a proportion of the value in the asset test, but this would be adding complexity for little benefit.

One would however want to prevent the issuing of multiple deferred annuities each for a limited period.in the means tests if 100% exemption was applied. Social Security rules with an Asset Test exemption for deferred annuities would effectively "bring-forward" Age Pension payments (as retirees can access Age Pension they would otherwise not receive). Under these test conditions, retirees are more likely to have a deferred annuity. These conditions should incentivise retirees to spend more in retirement than they would otherwise.

Integrity

Creating small incentives to defer income and insure against longevity are entirely consistent with superannuation policy and the associated tax incentives for people to prepare for retirement.

Equity

From a perspective of equity – age pensioners are likely to consider it unfair to test for something that they may never receive the benefit of. The Discussion Paper refers to "people with sufficient means shielding assets from the means test". I believe the recent passage of tax legislation effectively limiting the amount of assets held in superannuation will reduce this risk of people with large means exploiting the arrangements. Further, I believe that primary residential property exemption represents a much more significant risk in terms of driving behaviour to shield assets from the means test.

Product Neutrality

There is precedent for the asset test exemption of products in the deferral phase. In the Australian market there have been Guaranteed Minimum Withdrawal Benefit products, where the product providers have sought clarification from the Department in respect of the assets / income test treatment. These products can be thought of as containing a deferred income stream component and I understand that the Department agreed that no value was placed on the deferred income stream component for the purposes of assets test (during the deferral phase).

Q4. On what basis should deferred income stream products be assessed once they have commenced providing payments?

a. Which approach to establishing an assessable asset value best meets the policy principles of neutrality, equity, resilience, integrity, fiscal sustainability and simplicity?

If the deemed value of the asset reduced for a deferred life annuity in the same way as for an immediate life annuity (i.e. in line with life expectancy), the expected present value would be identical. This approach could therefore be taken for complete competitive neutrality between immediate and deferred annuities.

The tests after vesting could apply to either the initial premium paid or to the net present value of the annuity at vesting. My calculations for someone subject to the full asset test is that the fiscal costs are slightly lower if the initial premium is used. This is because the income from the annuity after vesting is larger because the capital deduction is smaller. The income is more likely to be subject to the income test.

b. How should income be assessed?

The current method of assessing annuity income fulfils the principles, not least because it creates a level income stream for means test purposes.

Q5. Are there other approaches or issues regarding the assessment of income streams with a deferral period that have not been canvassed above that it is important to consider?

Not that I am aware of.

Q6. Does assessing the actuarial value of complex and hybrid income stream products provide the most suitable approach to ensuring that the rules for these products satisfy the policy principles of neutrality, equity, resilience, integrity, fiscal sustainability and simplicity?

As for the answer to question 4, not necessarily. While it does provide a market consistent benchmark that allows for fair comparisons between products, I think that a simpler method is likely to produce fewer anomalies and is easier to explain.

Q7. Would assessing these products in terms their individual components better achieve these objectives? Are there circumstances in which this approach would be problematic?

Assessing products using their individual components would allow for neutrality between products, and avoid distorting product development. It would however also lead to greater complexity.

It could well create additional work if the valuation of the products does not require separate identification of components – such as death and survival benefits.

I suggest that this be considered as an option in order to ensure product neutrality, but that it not be required.

Q8. Is there a need for a determination process to provide binding advice on the treatment of particular income stream products? Would this assist in the development of innovative retirement income products?

It could certainly help. It would however be more useful if this could be combined with taxation rulings as there would otherwise be the potential for contradictory rulings on the same product.

Q9. Are there other approaches or issues not canvassed above that it is important to consider?

Not that I have discovered.

Q10. Are there current legislated definitions relating to income stream products that create ambiguity regarding means test treatments?

I believe as far as possible, the definitions used by the DSS should be consistent with (or refer to) those used in tax legislation and the SIS legislation. That being said, SIS Regulations 1.05 and 1.06 are extremely complicated, subject to misunderstanding and misinterpretation and obstacles to sensible product development. It would be helpful if new regulations did not refer to them. It would be useful to re-draft these in a more straight forward manner.

Q11. To what extent are interactions with means testing for other social policy systems, such as residential aged care important to the development of retirement income products?

They are important as pensioners are inevitably concerned with the costs of health and aged care – but also with the various discounts available for consumption items. The more complex the overall system, the more expensive to administer, stressful to navigate and the more likely the vulnerable will fail to take full advantage.

I do believe that there are potential advantages in bundling products - to both providers and consumers.[8]

[8] See for instance http://cepar.edu.au/media/165557/shang_wu.pdf

Appendix 1

The calculations below have removed inflation and assume a real rate of return of 3%, which is a relatively high estimate of the net return on a conservatively invested portfolio.

They start at age 67 (which is the age at which most people should be expecting to be able to receive the Age Pension, and which I use to shift thinking in this direction.)

The columns show the age; the balance for a person alive at that age; the loss of the Age Pension as a consequence of the asset test; the benefit received, the net gain for those living (or loss shown as a negative); the net gain allowing for survival and death (if a refund is given); and then the discounted value at the interest rate. If there were no asset test, the discounted value would be $100,000, being the initial investment.

In each case, I have ignored the charges for expenses and guarantees that would be made by the issuer of the products, which would make the position worse.

In these examples, I have ignored the income test is as it applies to a small range of assets so is less relevant, and is obviously consistent between investments when looked at on an annual basis. The asset test cannot however be compared on an annual basis as it has significantly differential effects over the lifetime.

Life annuity

Age	Balance	Loss of Age Pension	Annuity	Net gain	Net gain - allowing for survival	Net gain - allowing for survival & interest
67	100000					
68	96601	7410	7264	-146	-145	-141
69	93163	7020	7264	244	240	226
70	89693	6630	7264	634	617	564
71	86195	6240	7264	1024	984	875
72	82675	5850	7264	1414	1342	1157
73	79137	5460	7264	1804	1687	1413
74	75586	5070	7264	2194	2019	1641
75	72022	4680	7264	2584	2334	1843
76	68452	4290	7264	2974	2632	2017
77	64881	3900	7264	3364	2910	2165
78	61322	3510	7264	3754	3164	2286
79	57789	3120	7264	4144	3391	2378
80	54301	2730	7264	4534	3587	2443
81	50873	2340	7264	4924	3748	2478
82	47525	1950	7264	5314	3868	2483
83	44272	1560	7264	5704	3944	2458
84	41129	1170	7264	6094	3970	2402
85	38111	1132	7264	6132	3730	2191
86	35227	1132	7264	6132	3446	1965
87	32486	1132	7264	6132	3145	1741
88	29894	1132	7264	6132	2832	1522
89	27455	1132	7264	6132	2512	1311
90	25168	1132	7264	6132	2190	1110
91	23036	1132	7264	6132	1874	922
92	21053	1132	7264	6132	1570	750
93	19201	1132	7264	6132	1286	597
94	17448	1132	7264	6132	1030	463
95	15739	1132	7264	6132	804	352
96	14000	1132	7264	6132	613	260
97	12107	1132	7264	6132	456	188
98	9887	1132	7264	6132	332	133
99	7052	1132	7264	6132	236	92
100	0	1132	7264	6132	236	89
TOTAL				**148,671**	**66,585**	**42,374**

For an outlay of $100,000, the annuitant receives a present value of $42,374.

Term annuity

Age	Balance	Loss of Age Pension	Drawdown	Net gain - individual survives to 87	Net gain - allowing for survival probabilities	Net gain - allowing for survival & interest
67	100000					
68	96278	7410	6722	-688	203	197
69	92445	7020	6722	-298	655	617
70	88497	6630	6722	92	1098	1005
71	84430	6240	6722	482	1535	1364
72	80242	5850	6722	872	1959	1690
73	75927	5460	6722	1262	2368	1983
74	71484	5070	6722	1652	2756	2241
75	66907	4680	6722	2042	3123	2465
76	62192	4290	6722	2432	3463	2654
77	57336	3900	6722	2822	3778	2811
78	52335	3510	6722	3212	4061	2934
79	47183	3120	6722	3602	4303	3018
80	41877	2730	6722	3992	4495	3061
81	36412	2340	6722	4382	4624	3057
82	30783	1950	6722	4772	4679	3003
83	24985	1560	6722	5162	4647	2896
84	19013	1170	6722	5552	4518	2734
85	12862	780	6722	5861	4235	2488
86	6526	390	6722	5861	3677	2097
87	0	0	6722	5861	3060	1694
	TOTAL			**58,919**	**63,238**	**44,010**

For an outlay of $100,000, the annuitant and heirs receive a present value of $44,010. This is not too dissimilar to the annuity, because of the death benefits received by the heirs.

Account-based income stream – minimum drawdown

Age	Balance	Loss of Age Pension	Drawdown	Net gain - individual survives to 100	Net gain - allowing for survival	Net gain - allowing for survival & interest
67	100000					
68	98000	7644	5000	-2644	-1828	-1775
69	96040	7491	4900	-2591	-1690	-1593
70	94119	7341	4802	-2539	-1541	-1411
71	92237	7194	4706	-2489	-1388	-1233
72	90392	7051	4612	-2439	-1225	-1057
73	88584	6910	4520	-2390	-1056	-884
74	86813	6771	4429	-2342	-879	-714
75	84208	6568	5209	-1359	150	118
76	81682	6371	5052	-1319	303	232
77	79231	6180	4901	-1279	461	343
78	76855	5995	4754	-1241	631	456
79	74549	5815	4611	-1204	813	570
80	71567	5582	5218	-364	1644	1120
81	68704	5359	5010	-349	1788	1182
82	65956	5145	4809	-335	1934	1241
83	63318	4939	4617	-322	2078	1295
84	60785	4741	4432	-309	2212	1338
85	57138	4457	5471	1014	3132	1839
86	53710	4189	5142	953	3069	1750
87	50487	3938	4834	896	2977	1648
88	47458	3702	4544	842	2854	1534
89	44610	3480	4271	792	2697	1407
90	41042	3201	4907	1706	2852	1445
91	37758	2945	4515	1569	2509	1234
92	34738	2710	4153	1444	2162	1033
93	31959	2493	3821	1328	1818	843
94	29402	2293	3515	1222	1488	670
95	26168	2041	4116	2075	1309	572
96	23289	1817	3663	1847	968	411
97	20727	1617	3260	1644	694	286
98	18447	1439	2902	1463	484	193
99	16418	1281	2583	1302	327	127
100	14612	1140	2299	1159	607	229
	TOTAL			**-4,259**	**32,354**	**14,452**

For an outlay of $100,000, the annuitant and heirs receive a present value of only $14,452. This is much worse than the shorter terms because the loss of more Age Pension. The death benefits received do not compensate.

Drawing investment return/interest only

	Balance	Loss of Age Pension	Interest	Net gain - individual survives to 100	Net gain - allowing for survival	Net gain - allowing for survival & interest
67	100000					
68	100000	7800	3000	-4800	-3967	-3852
69	100000	7800	3000	-4800	-3844	-3623
70	100000	7800	3000	-4800	-3703	-3389
71	100000	7800	3000	-4800	-3549	-3153
72	100000	7800	3000	-4800	-3376	-2912
73	100000	7800	3000	-4800	-3187	-2669
74	100000	7800	3000	-4800	-2978	-2421
75	100000	7800	3000	-4800	-2753	-2173
76	100000	7800	3000	-4800	-2507	-1922
77	100000	7800	3000	-4800	-2238	-1665
78	100000	7800	3000	-4800	-1934	-1397
79	100000	7800	3000	-4800	-1594	-1118
80	100000	7800	3000	-4800	-1214	-827
81	100000	7800	3000	-4800	-793	-525
82	100000	7800	3000	-4800	-334	-215
83	100000	7800	3000	-4800	158	98
84	100000	7800	3000	-4800	672	407
85	100000	7800	3000	-4800	1197	703
86	100000	7800	3000	-4800	1714	978
87	100000	7800	3000	-4800	2202	1219
88	100000	7800	3000	-4800	2642	1420
89	100000	7800	3000	-4800	3008	1570
90	100000	7800	3000	-4800	3280	1662
91	100000	7800	3000	-4800	3445	1695
92	100000	7800	3000	-4800	3487	1665
93	100000	7800	3000	-4800	3396	1575
94	100000	7800	3000	-4800	3182	1433
95	100000	7800	3000	-4800	2867	1253
96	100000	7800	3000	-4800	2487	1055
97	100000	7800	3000	-4800	2076	855
98	100000	7800	3000	-4800	1674	670
99	100000	7800	3000	-4800	1303	506
100	100000	7800	3000	-4800	3665	1382
	TOTAL			- 158,400	4,485	- 11,714

For an investment of $100,000, the investor and heirs are worse off by present value of $11,714. The loss to a survivor is of course much worse, but the death benefits compensate partly – but only a later ages so the expected value is below zero. The money should be spent as early as possible!

Appendix 2

2.1 Drawing legal minimum

				Benefit - allowing for survival & interest	
	Balance	Loss of AP	Drawdown	Pensioner	Heirs
62	481859				
63	496315			0	2303
64	511204			0	2492
65	526540			0	2702
66	542337			0	2943
67	531490	21956	27117	4325	3214
68	520860	21127	26574	4400	3345
69	510443	20315	26043	4454	3502
70	500234	19518	25522	4491	3667
71	490229	18738	25012	4509	3858
72	480425	17973	24511	4510	4054
73	470816	17224	24021	4493	4267
74	461400	16489	23541	4460	4486
75	447558	15410	27684	7416	4715
76	434131	14362	26853	7195	4887
77	421107	13346	26048	6959	5063
78	408474	12361	25266	6709	5242
79	396220	11405	24508	6444	5444
80	380371	10169	27735	8143	5667
81	365156	8982	26626	7677	5847
82	350550	7843	25561	7201	6033
83	336528	6749	24538	6713	6213
84	323067	5699	23557	6214	6371
85	303683	4187	29076	7923	6489
86	285462	2766	27331	7089	6417
87	268334	1859	25692	6168	6276
88	252234	1598	24150	5173	6055
89	237100	1352	22701	4281	5757
90	218132	1044	26081	4323	5379
91	200681	760	23995	3396	4824
92	184627	499	22075	2619	4237
93	169857	259	20309	1980	3634
94	156268	38	18684	1465	3030
95	139079	0	21878	1336	2452
96	123780	0	19471	902	1857
97	110164	0	17329	594	1362
98	98046	0	15423	382	965
99	87261	0	13726	240	663
100	77662	0	12217	148	441
TOTAL	**311,420**			**154,537**	**156,884**

The means tests effectively reduces the value of assets from $481 000 to $311,000 (35%)

2.2 Give away and draw legal minimum

				Benefit - allowing for survival & interest	
	Balance	Loss of AP	Drawdown	Pensioner	Heirs
62	222122				
63	228786			0	1062
64	235649			0	1149
65	242719			0	1246
66	250000			0	1356
67	245000	1480	12500	9236	1481
68	240100	1401	12250	8762	1542
69	235298	1323	12005	8307	1614
70	230592	1246	11765	7868	1690
71	225980	1171	11530	7445	1779
72	221461	1098	11299	7036	1869
73	217032	1026	11073	6641	1967
74	212691	955	10852	6260	2068
75	206310	852	12761	7196	2174
76	200121	751	12379	6697	2253
77	194117	653	12007	6220	2334
78	188294	559	11647	5764	2416
79	182645	467	11298	5326	2510
80	175339	348	12785	5765	2612
81	168326	234	12274	5239	2695
82	161593	125	11783	4738	2781
83	155129	20	11311	4261	2864
84	148924	0	10859	3779	2937
85	139988	0	13403	4267	2991
86	131589	0	12599	3636	2958
87	123694	0	11843	3065	2893
88	116272	0	11132	2553	2791
89	109296	0	10464	2098	2654
90	100552	0	12023	2076	2479
91	92508	0	11061	1617	2224
92	85107	0	10176	1235	1953
93	78299	0	9362	925	1675
94	72035	0	8613	677	1397
95	64111	0	10085	616	1130
96	57059	0	8976	416	856
97	50782	0	7988	274	628
98	45196	0	7110	176	445
99	40225	0	6327	111	306
100	35800	0	5631	68	203
TOTAL	**472,499**			**140,443**	**72,319**

The means tests effectively reduces the value of assets from $481 000 to $472,500 (2%), with pensioner losing $14,000 and heirs gaining $175,000 relative to not keeping the money.

2.3 Maintain comfortable as long as possible

				Benefit - allowing for survival & interest	
	Balance	Loss of AP	Drawdown	Pensioner	Heirs
62	481859				
63	496315			0	2372
64	511204			0	2644
65	526540			0	2953
66	542337			0	3312
67	515309	22802	43298	19915	3726
68	489579	20694	41190	19765	3872
69	465084	18687	39183	19601	4049
70	441764	16777	37272	19419	4233
71	419564	14958	35453	19219	4446
72	398430	13226	33721	18998	4663
73	378310	11578	32073	18753	4899
74	359155	10008	30504	18483	5140
75	340920	8514	29010	18184	5390
76	323561	7092	27587	17856	5631
77	307035	5738	26233	17494	5879
78	291302	4449	24944	17097	6133
79	276324	3222	23717	16658	6418
80	262065	2053	22549	16174	6728
81	247674	1758	22253	15638	7063
82	237767	1524	17337	11607	7391
83	228256	1363	16644	10727	7839
84	219126	1208	15978	9848	8279
85	205978	1060	19721	11725	8687
86	193620	846	18538	10378	8848
87	182002	645	17426	9093	8912
88	171082	457	16380	7877	8857
89	160817	279	15397	6734	8674
90	147952	112	17690	6944	8347
91	136116	0	16275	5606	7710
92	125227	0	14973	4412	6976
93	115208	0	13775	3401	6161
94	105992	0	12673	2564	5293
95	94333	0	14839	2403	4410
96	83956	0	13207	1671	3441
97	74721	0	11754	1134	2599
98	66502	0	10461	751	1897
99	59186	0	9310	486	1342
100	52676	0	8286	308	919
TOTAL	**364,630**			**246,520**	**118,111**

The means tests effectively reduce the value of assets from $481 000 to $365,000 (24%), of which the heirs get about a third, but income to the pensioner will fall by about 2% pa about after 82.

2.4 Maintain comfortable as long as possible (income test only)

				Benefit - allowing for survival & interest	
	Balance	Loss of AP	Drawdown	Pensioner	Heirs
62	481859				
63	496315			2361	0
64	511204			2618	0
65	526540			2907	0
66	542337			3240	0
67	531490	6312	27117	23263	17438
68	520803	6136	26631	22913	16553
69	509970	5962	26457	22864	15937
70	498988	5786	26281	22798	15330
71	487854	5608	26103	22731	14730
72	476568	5427	25922	22636	14136
73	465126	5243	25739	22521	13548
74	453528	5057	25553	22367	12964
75	439922	4869	27212	23627	13499
76	426724	4648	26395	22837	12526
77	413922	4433	25603	22042	11599
78	401505	4225	24835	21238	10714
79	389031	4023	24519	20729	10079
80	373470	3821	27232	22055	10852
81	358531	3568	26143	20822	9823
82	344190	3325	25097	19583	8848
83	330422	3092	24093	18316	7925
84	316971	2868	23364	17104	7132
85	297953	2650	28527	18110	8238
86	280076	2341	26816	15929	7063
87	263271	2050	25207	13786	5993
88	247475	1777	23694	11700	5027
89	232626	1520	22273	9706	4161
90	214016	1279	25589	8563	4197
91	196895	977	23542	6519	3298
92	181143	699	21658	4794	2545
93	166652	443	19926	3389	1924
94	153320	207	18332	2291	1424
95	136455	0	21465	1596	1310
96	121445	0	19104	935	885
97	108086	0	17002	521	583
98	96196	0	15132	275	375
99	85615	0	13467	138	235
100	76197	0	11986	66	145
TOTAL	**425,879**			**271,238**	**154,640**

Abolishing the asset test would lead to a 12% loss of the present value.

Appendix 3

Based on market values

Age	Balance	Loss of AP	Annuity	Net gain	Net gain - allowing for survival	Net gain - allowing for survival & interest at 2%
67	20000					
68	20773	1579		-1579	-1566	-1520
69	21596	1641		-1641	-1613	-1520
70	22475	1708		-1708	-1661	-1520
71	23419	1780		-1780	-1711	-1520
72	24436	1857		-1857	-1762	-1520
73	25537	1941		-1941	-1815	-1520
74	26736	2032		-2032	-1869	-1520
75	28045	2131		-2131	-1925	-1520
76	29483	2241		-2241	-1983	-1520
77	31073	2362		-2362	-2043	-1520
78	32848	2496		-2496	-2104	-1520
79	34847	2648		-2648	-2167	-1520
80	37123	2821		-2821	-2232	-1520
81	39746	3021		-3021	-2299	-1520
82	42805	3253		-3253	-2368	-1520
83	46418	3528		-3528	-2439	-1520
84	50739	3856		-3856	-2512	-1520
85	47015	3396	8961	5565	3385	1988
86	43458	2835	8961	6127	3443	1963
87	40076	2273	8961	6688	3430	1899
88	36879	1712	8961	7249	3348	1800
89	33869	1151	8961	7811	3200	1670
90	31049	882	8961	8080	2886	1462
91	28418	882	8961	8080	2469	1215
92	25972	882	8961	8080	2069	988
93	23688	882	8961	8080	1695	786
94	21525	882	8961	8080	1357	611
95	19417	882	8961	8080	1060	463
96	17271	882	8961	8080	808	343
97	14935	882	8961	8080	601	248
98	12197	882	8961	8080	437	175
99	8700	882	8961	8080	311	121
100	0	882	8961	8080	311	117
TOTAL				- 81,419	- 3,260	- 9,991
PRE VESTING				- 40,895	- 34,070	- 25,840
POST VESTING				122,314	30,810	15,849

For $20,000 in a deferred annuity, the next gain would be negative if the asset was counted pre-vesting, but worth about $15,000 to survivors.

Based on initial values

Age	Balance	Loss of AP	Annuity	Net gain	Net gain - allowing for survival	Net gain - allowing for survival & interest at 2%
67	14494.2		14494.2			
68	15054	1102	15054	-1102	-1092	-1061
69	15651	1102	15651	-1102	-1082	-1020
70	16288	1102	16288	-1102	-1071	-980
71	16972	1102	16972	-1102	-1059	-941
72	17709	1102	17709	-1102	-1045	-902
73	18507	1102	18507	-1102	-1030	-863
74	19376	1102	19376	-1102	-1013	-824
75	20324	1102	20324	-1102	-995	-786
76	21367	1102	21367	-1102	-975	-747
77	22519	1102	22519	-1102	-953	-709
78	23805	1102	23805	-1102	-928	-671
79	25254	1102	25254	-1102	-901	-632
80	26904	1102	26904	-1102	-872	-593
81	28804	1102	28804	-1102	-838	-554
82	31021	1102	31021	-1102	-802	-515
83	33640	1102	33640	-1102	-762	-475
84	36771	1102	36771	-1102	-718	-434
85	34073	2219	34073	4275	2600	1528
86	31495	2219	31495	4275	2402	1370
87	29044	2219	29044	4275	2193	1214
88	26727	2219	26727	4275	1975	1061
89	24546	2219	24546	4275	1751	914
90	22501	2219	22501	4275	1527	774
91	20595	2219	20595	4275	1306	643
92	18822	2219	18822	4275	1095	523
93	17167	2219	17167	4275	897	416
94	15599	2219	15599	4275	718	323
95	14072	2219	14072	4275	561	245
96	12516	2219	12516	4275	428	181
97	10824	2219	10824	4275	318	131
98	8839	2219	8839	4275	231	93
99	6305	2219	6305	4275	165	64
100	0	2219	0	4275	165	62
TOTAL				49,677	2,194	- 3,165
PRE VESTING				- 18,727	- 16,137	- 12,706
POST VESTING				68,404	18,332	9,542

For $20,000 in a deferred annuity, the next gain would be negative if the asset was counted pre-vesting, but worth about $9,500 to survivors.