AUSTRALIAN INSTITUTE of SUPERANNUATION TRUSTEES

16 February 2018

Via email

Email: RetirementIncomeStreams@dss.gov.au

Dear Sir/Madam,

Re: Means Test Rules for Lifetime Retirement Income Streams Position Paper

In brief:
In this submission, AIST offers a guarded support for the proposed means test treatment outlined in the Position Paper. Whilst we support the principles underpinning this paper, we do not believe that there has been an appropriate balancing of these principles, and suggest that fiscal sustainability should not drive means testing rules. AIST offers suggestions aimed at improving these measures, and supports the use of grandfathering to protect existing pensioners.

AIST thanks the Department of Social Services (DSS) for the opportunity to comment on this Position Paper (the "Paper"). Our response in this submission is intended to be brief, and to remain a high-level discussion of policy issues. However, in short, we offer a guarded support for the proposed new rules outlined in this paper. We do have some reservations in relation to some of the rules proposed, and believe that a more detailed case needs to be made in relation to some of them. The main deficiencies arise from the lack of placing these proposed changes within the context of a broader retirement incomes framework which would ideally include tax treatments. Additionally, in examining these proposals, there is work that we believe would benefit this transition from a policy perspective.

Executive summary

- AIST supports the principles underpinning the proposals. However, the proposals do not always reflect an appropriate balancing of these principles.
- In particular, fiscal sustainability should not drive means testing rules. Superannuation should not be used the balance the budget.

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- Further, neutrality is very important. If the means testing rules favour particular products, many retirees will purchase these products even if there are other products which would better serve their needs.
- AIST supports the proposal that where retirees have already purchased retirement income products, grandfathering arrangements should apply.
- Deferred products should be income test exempt during the deferral period.
- The cameo modelling assumes a life expectancy of 110. This is clearly unrealistic.

Objectives

The Australian retirement system comprises four main pillars (age pension, compulsory superannuation, voluntary contributions, and other forms of support including family and age care), which AIST strongly supports. AIST recognises that any examination of retirement incomes should examine how the four components interact. The objectives of the four pillars include adequacy, to provide an income in retirement, to deliver a sustainable retirement incomes system, and provide a fair retirement incomes system. This is why AIST supports the implementation of a broader retirement incomes policy, including the work presently underway at Treasury. It is important that such a framework is developed, so that retirement incomes proposals are assessed within the context of how the four pillars interact.

Policy statement

AIST supports the intent for these new rules to provide fairness, appropriateness and sustainability in relation to means test outcomes for all pooled retirement income products. We have supported the work already undertaken by Treasury to remove impediments to the provision of new innovative retirement income streams.

Need for a retirement incomes framework to provide context

We express with some frustration that despite the work we have described above proceeding, we are still uncertain of the overriding policy under which this work is intended to be united. We appreciate that it is not the role of this paper, nor of DSS, to provide a statement such as this, however the industry requires certainty. We believe that it would be helpful to know what the Government's intended outcome for the MyRetirement framework is prior to the development of a comprehensive means testing framework.

Principles within the Paper supported but come into conflict with each other

AIST supports the stated policy principles of neutrality, equity, resilience, integrity, fiscal sustainability and simplicity as stated in the Paper. However, we are also mindful that throughout this paper, there are instances where these principles have come into conflict with each other, which this paper acknowledges.

This conflict reinforces the need to have a retirement incomes framework against which proposals can be assessed. Then, the proposals within the Paper could be assessed against the framework as to how they support the Government's retirement incomes policy. In the absence of such a framework, the Paper overly relies on the policy basis of social security means testing. We have discussed in broader detail our concerns in relation to these policy principles below.

Insufficient balancing of key objectives and priorities

AIST has concerns that overriding importance has been applied to the fiscal sustainability principle. Superannuation is the environment which Australians save for their retirement and should not be used as a mechanism for balancing budgets. We note a number of changes to means testing of retirement income streams from the past 20 years have been implemented, yet are not aware of any reasons provided by Government other than the need for fiscal sustainability. We wish to make clear that changes to the eligibility for social security act as a significant driver of financial decisions in retirement, and it must be a principle that social security planning should not drive Australians into inappropriate retirement income products. In addition, in the absence of policy guidance, the availability (or otherwise) of Age Pension benefits must not drive artificial outcomes in relation to the development and provision of retirement income stream products. Trustees must be free to develop products which best satisfy the needs of super fund members.

Addressing the stated policy principles and means testing

AIST supports the focus on neutrality. However, the lack of an overarching policy direction from Government on retirement incomes has hampered the use of social security as a policy lever in this area. Deeming was introduced on retirement incomes in 2015, and as a result of this change, retirement income streams were treated similarly to non-super investments. Yet concerns remain that Australians are taking superannuation as lump sums rather than income streams, which prior policy settings were designed to encourage.

We therefore question why neutrality in this instance only appears to extend to income streams (including non-super income streams), and not all the way to other non-super investments which might be available.

Scope of the new rules

We note that the paper recognises that:

> *Where retirees have already purchased lifetime income products prior to implementation of the new rules, there is a strong case for grandfathering these investments so that the current rules continue to apply*

AIST supports this. We support the use of grandfathering to ensure that existing holders of income streams are given the opportunity to rely on the certainty of the existing (or previously grandfathered) treatment.

However, the paper is silent on whether holders of income streams that are compliant with previous treatments will retain the right to change providers. This already exists with certain complying income streams commenced prior to 2007, where the ability to commute to commence a new equivalent income stream (with either the same or a different provider) is allowed under the rules without affecting means testing treatment.

Recommendation: AIST recommends that the right to change providers or re-commence equivalent income streams for grandfathered products be included within the new rules. We believe that this measure would also ensure that members do not get isolated in legacy products that are difficult to escape.

Proposed new means test rules for pooled lifetime income streams

The idea of a simple rule in relation to the income and assets test is an attractive one and we applaud the willingness to propose this. However, we are uncertain how DSS arrived at the 70% and 35% figures proposed and believe that further explanation would have been useful.

AIST generally supports the proposed new means test rules for lifetime income products where 70% of the income is counted towards the income test.

In regard to the assets test where 70% of the notional purchase price is tested up to life expectancy and then 35% thereafter, we have substantial concerns.

The notion that the asset value, set by the notional purchase price, being the same across the life of the income stream is not entirely correct. Whilst at the surface, the income payable to the recipient will not change (disregarding indexation and instances where non-guaranteed income streams such as GSAs are used), there is an ever-decreasing number of payments left to be paid to the member as that person reaches the end of their life.

Where such products are also subject to the declining capital access schedule, this provides an additional lens through which to view this effect. This comparison gets less accurate as one outlives the life expectancy which would have applied at income stream commencement, however is mostly useful.

We would agree that a loss of flexibility needs to be factored in early in the life of the income stream to ensure that appropriate price signals drive behaviour amongst members at the time that they are choosing retirement income streams. In keeping with this, AIST would support a schedule where the assets test concession gradually increases with age and would accept that

70% is a reasonable commencement point. This would additionally recognise that more capital is being returned to the member in the later stages of the investment.

Assessment of deferred products

The treatment of amounts during a deferral period requires some thought. We consider that the proposal to not assess these products under the income test during deferral periods is sensible, given that no income is actually paid.

On the other hand, the question of whether the product should be assessed under the assets test is a vexed one. We note that for members who have chosen longer deferral periods, such as those described in the attachment to the end of the Position Paper, there may be a risk that members are assessed against assets that they ultimately fail to get an actual benefit from. This may act as a disincentive against these products. We consider that, irrespective of withdrawal or death benefits, there is a clear asset value to such a product: For members with large superannuation balances at retirement who have a family history of longevity, it is expected that these products will be in demand.

We would recommend that to the extent that withdrawal and/or death benefits are available during the deferral period, ordinary asset testing should apply and can be readily ascertained with respect to these figures. This should be assessed at the greater of these benefits, if they are of different values.

Yet the question of what method to use in the instance of where capital access of any description is unavailable or restricted presents itself. Clearly, the pricing of income at the end of a deferral period is intended to be adjustable to compensate for this loss of flexibility. And it is this future income for which investors would be purchasing these products.

Compensation to the member for lack of flexibility and quarantined capital/deferred consumption, could still be provided through means testing in the form of a concession or an exemption to the extent that there is no withdrawal benefit or death benefit payable during the deferral period. This could be based on a variety of methods, where examples might include concessions or exemptions which could apply depending upon, for example:

- How much of the product remains unavailable until vesting;
- The first $50-$100,000 of the purchase price; or
- A partial amount corresponding to half the unavailable portion (similar to the pre-2007 complying income stream treatment), shading out along a straight line to zero when fully vested.

We believe that if appropriate compensation is not provided for limiting flexibility, investors may consider these limitations sufficiently unattractive to prevent purchase and usage. We take this opportunity to remind that opportunities to use tax as an incentive are not available, and reiterate that social security is the only viable policy lever available.

In this context, AIST strongly recommends that such incentives be capped at a set dollar figure so as to limit misuse by wealthier retirees, financial planners or financial product manufacturers.

Assessment of surrender values and death benefits where access to capital is not constrained by the new capital access schedule

AIST supports the proposed treatment and notes that this is consistent with a number of suggestions made in this submission.

Concerns regarding legacy products

We return to our previous remarks regarding the number of changes to means testing in previous years, and note the generation of legacy products that has accompanied such changes. We wish to make it clear that the creation of another cohort of isolated members who are locked into legacy products because of means testing changes is undesirable.

Concerns regarding the lack of participation by financial planners

We wish to express some concern regarding the apparently lack of participation in this consultation by financial advisers. Whilst we would agree to the extent that entities involved in consultation are generally also the providers of financial advice (in addition to being product providers), there are numerous instances where product providers are making representations to their members that are inconsistent with advice being provided about those same products. Consequently, we are not convinced that the information flow from product manufacturers to research providers through to financial advisers is reliable.

AIST recommends that financial planners be proactively engaged in the consultation process as a matter of urgency.

For further information regarding our submission, please contact Richard Webb, Policy & Regulatory Analyst at 03 8677 3835 or at rwebb@aist.asn.au .

Yours sincerely,

Eva Scheerlinck
Chief Executive Officer

The Australian Institute of Superannuation Trustees is a national not-for-profit organisation whose membership consists of the trustee directors and staff of industry, corporate and public-sector funds.

As the principal advocate and peak representative body for the $700 billion profit-to-members superannuation sector, AIST plays a key role in policy development and is a leading provider of research.

AIST provides professional training and support for trustees and fund staff to help them meet the challenges of managing superannuation funds and advancing the interests of their fund members. Each year, AIST hosts the Conference of Major Superannuation Funds (CMSF), in addition to numerous other industry conferences and events.