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Department of Social Security

Email: **RetirementIncomeStreams@dss.gov.au**

Dear Sir/Madam

Means Test Rules for Lifetime Retirement Income Streams

In January 2018, the Department of Social Services (DSS) released a position paper that sets out proposed new social security means test rules for pooled lifetime retirement income stream products. We support any effort to change the underlying narrative in the superannuation industry from a focus on the accumulated lump sum benefit at the time of retirement to providing an income throughout the retirement years. As such, we believe that it is vital to have appropriate means testing treatment that does not act as a disincentive to retirees to invest in lifetime retirement income streams.

In particular, it is important to note that, even if the total financial outcomes are the same between different products, this would not satisfy the neutrality principle because it does not recognise the behavioural impacts. For example, a retiree who invests in a lifetime retirement income stream will generally lose access to some or all of their capital, leading to a liquidity cost to the retiree which is not recognised in the analysis in the position paper. This is also known as "present-bias", with people preferring products that provide immediate access to all the capital, even if it is not necessary, compared to products where the capital is gradually released over time. In order to be product neutral, there needs to be some form of financial incentive to overcome the negative behavioural aspects.

We note that the position paper includes a limited number of modelled scenarios, and a more thorough analysis requires detailed modelling which has not been feasible within the timeframe allowed for submissions. In particular, we note that:

- All modelled scenarios assume that products are purchased at age 65. A robust means testing treatment should properly analyse the impact of the proposals on retirees who purchase products at older ages. Later purchases could arise for a variety of reasons, such as individuals choosing to retire later, or employing strategies under which the purchase of lifetime retirement income streams is deferred or occurs over a period of time.

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- The modelled scenarios assume that retirees draw down from account-based income stream at minimum drawdown rates. While a large number of retirees do draw down at minimum rates, those with lower assets, who are more likely to be impacted by means testing, tend to draw down at higher rates. The assumption of minimum drawdowns also effectively assumes that retirees with different product choices are willing to have fundamentally different lifestyles available to them. In general, it assumes that a retiree with an account-based income stream is willing to have a more frugal lifestyle than a retiree with a lifetime retirement income stream. While a retiree may currently drawdown at lower rates to reduce the risk of running out of retirement funds, it is worth noting that the Government's framework for comprehensive income products for retirement (CIPRs) is intended to increase the standard of living in retirement, and increase the efficiency of the superannuation system, by encouraging the availability and take-up of products that more efficiently manage longevity risk.
- The analysis makes no allowance for the impacts of risk, with only central estimate outcomes being considered.

We have set out below some comments on the proposals based on a review of the position paper. While we see the simplicity of the proposals as a significant positive, there may be unintended consequences that deter retirees from purchasing lifetime retirement income streams.

1. In comparing outcomes, the focus should be on the total value that a retiree derives from the product, including any bequest. The charts in the position paper consider only income, and the tables highlight the present value of total income for each scenario.
2. When the total outcomes are considered, including bequests, the proposals result in a significant disincentive to lifetime retirement income streams. For example, based on the tables on page 16 of the position paper, a single homeowner with $300,000 in superannuation and no other assessable assets will have their total outcome reduced by around $40,000, or 6% of total outcome, under a lifetime annuity or group self-annuity product compared to an account-based income stream.
3. The proposals have a greater adverse impact on those with lower means. For example, comparing the tables on pages 16 and 19 of the position paper, a single homeowner with $600,000 in superannuation and no other assessable assets has around the same outcome between an account-based income stream and a lifetime annuity or group self-annuity product, compared to the 6% detriment for the single homeowner with $300,000 in assets. This is particularly important for the future development of CIPRs considering the current (and future medium term) average balances at retirement are below $300,000 (see below).
4. The income test percentage appears high compared with the proportion of an annuity payment that is made up of earnings. For example, the charts on page 15 of the position paper appear to have a lifetime annuity payment of around $14,000 per annum, CPI indexed, purchased for $300,000. Assuming 70% of this amount is assessed as income, then 30%, or $4,200 per annum CPI indexed, is recognised as a return of capital. Assuming CPI of 2.5%, the retiree would need to live for around 42 years, to age 107, before receiving income testing credit for their capital contribution.

5. The step down in assets test percentage at life expectancy at the time of purchase could result in complexity if a retiree purchases multiple products at different times, which leads to the asset test amount changing at different times.

6. It is unclear how the proposals will interact with the Government policy objectives of introducing CIPRs. We have noted in submissions to Treasury that an understanding of the means testing treatment of these products will be crucial to put the industry in a position to develop CIPRs that will be accepted by the community and drive the behaviours we are seeking to produce more efficient retirement outcomes for the majority of Australians. A further principle for developing the new means testing rules could be to support Government policy. Considering the average retirement balance is less than $300,000, based on the current proposal, it will difficult for a trustee to consider a CIPR (with a longevity component) to be in members' best interests when the total outcome (as shown in the table on page 16) is worse than for an account based pension.

7. We agree that it is appropriate that deferred lifetime income streams are not subject to the income test during any deferral period. We consider that further analysis will be required to determine whether there are any unintended consequences under the assets test.

As stated above, a more thorough analysis of the proposals requires detailed modelling which has not been feasible within the timeframes allowed for submissions. Despite this, we have proposed below a potential amendment to the proposals which may result in more appropriate outcomes:

1. The step down in assets test could be set at a fixed age, say 85. This would assist in simplifying the means test, as multiple products would step down at the same time, and also potentially reduce any disincentive for older retirees to purchase lifetime retirement income streams.

2. The income test, which appears to cause the more adverse outcomes, could be amended to:

    a. Start at a lower level, say 60%; and

    b. Step down in a similar manner as the assets test at age 85 to say 30%.

Using a similar approach to that set out in point 5 above, the retiree would need to live for 29 years, to age 94, in order to receive income testing credit for their capital contribution. This appears to be a more reasonable expectation.

Should you wish to discuss any aspect of this submission or arrange a meeting with Institute representatives please do not hesitate to contact me (phone 02 9239 6100 or email elayne.grace@actuaries.asn.au).

Yours sincerely

Elayne Grace

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