Means test rules for lifetime retirement income streams

Joint response to Department of Social Services position paper on assets and income testing

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1 Introduction

FSS Trustee Corporation is the trustee of the First State Superannuation Scheme (First State Super or the Fund). We are dedicated to helping our members achieve a better financial future. Most of our members work in public and community service occupations. They are nurses, midwives, health workers, teachers, police, fire fighters and paramedics. Over 65% of our members are women.

First State Super wholly owns First State Super Financial Services Pty Limited (FSS Financial Services). FSS Financial Services provides financial planning services to First State Super members and other clients. In 2016, First State Super purchased StatePlus, a financial planning business previously owned by NSW-based State Super. The combined fund represents over 800,000 members and advice clients, and is one of Australia's largest funds with $89 billion under management.

This document contains our response to the Department of Social Services (DSS) position paper on "Means Test Rules for Lifetime Retirement Income Streams" as updated on 7 February 2018.

2 Longevity products

In general terms, the main aim of superannuation is to provide members, in conjunction with DSS, with an adequate income for life in retirement, through a combination of private savings and publicly funded Age Pension.

However, it is a vexing truism that none of us know in advance our own expectation of life. Many members underestimate their potential length of life and hence "over spend" resulting in their superannuation monies running out early. In contrast, many other members attempt to mitigate the effects of uncertainty arising from longevity by living overly frugally, consequently leaving unintentionally large bequests. Neither scenario is satisfactory, and a potential solution is for members to use products designed to eliminate the longevity risk (longevity products).

We welcome the potential introduction of more longevity products in Australia and would be pleased to offer them to members on an advised basis, provided these products prove to be in our members' best interests.

3 Simplicity and product neutrality

As a preliminary comment, we also welcome the simplicity of the proposed rules. There are many complexities in Australian superannuation regulations, and this complexity is a known deterrent to member engagement. It is pleasing that the proposal does not add to the complexity of the system.

There are well known barriers to member acceptance of longevity products. These include:

- Lack of availability to capital (and flexibility), whether for immediate use or as a hedge against accommodation and care costs in later life,
- Potential limitations to a member's ability to leave a bequest, and

- Member concerns about losing out in the event of early death (the trade-off can be difficult to explain).

Therefore, and as previously noted in earlier consultations, we consider that the means testing approach to longevity products should be neutral to slightly favourable, compared with account based pensions (ABPs), because it will be important to:

- Provide a "nudge" to members in order to make the products more appealing, and help members achieve more predictable income streams in retirement for longer,
- Help the Government to achieve its objective "to replace or supplement the Age Pension",
- Ensure we avoid wide proliferation of sub-economic products which increases funds' cost bases and leads to effective cross-subsidisation of this product group by other, simpler and more intuitively appealing products.

Despite this, our assessment of the proposal in the DSS paper is that longevity products are treated neutrally to unfavourably for the vast majority of our members, particularly for members with lower balances or at older ages. We do acknowledge that the proposed treatment is favourable for members with higher balances.

4 Favourability for our members

We have used the present value metric to assess total outcomes for our members of the different products, including the impact of the Age Pension. That is, we have used the method set out by the Government Actuary, including results shown in the updated position paper of 7 February 2018.

The products that we have considered include:

- 100% ABP,
- 100% immediate Life Annuity (LA),
- 30% Deferred Life Annuity (DLA) / 70% ABP, and
- 30% LA / 70% ABP
- 100% Group Self Annuitized products (GSAs).

Lower balances

The Government Actuary's analysis shows that the DSS proposals disadvantage longevity products for members with relatively low balances, compared with relatively high balances. First State Super's member balances are at the relatively low end of the scale, with the average balance in our income stream products being in the order of $300,000.

We make the following comments about means testing of these products for our membership:

- At the $300,000 balance, for a 65-year-old single home owner:
    - 100% ABP is more favourably treated than all of 100% LA, 100% GSA, and 30% LA / 70% ABP, and

  - this effect is most marked in the early years through to about age 90, after which the higher weighted longevity products result in better outcomes for members in the $300,000 balance range.

- Even the 30% DLA / 70% ABP is slightly less favourably treated than 100% ABP, and there are other factors to take into account here (see following section on Deferred Annuities below).
- Similarly, for a couple with a balance of $400,000, the 100% ABP is treated more favourably than 100% LA, 100% GSA, 30% DLA / 70% ABP, and 30% LA / 70% ABP.

Older pensioners

The above analysis has been carried out for members aged 65; we think older ages could be re-modelled. For a number of reasons, it is likely that members will seek to take advantage of longevity products at higher ages:

- Product providers have indicated that the average age of purchase of longevity products is greater than age 65,
- The eligibility age for the Age Pension is being increased to 67,
- It makes sense for immediately retired members to purchase an account based pension while they assess their personal and financial situation. At a later stage, after they have adjusted to their retirement lifestyle, they can consider committing to less flexible arrangements such as longevity products.

Our analysis shows that longevity products fare even less favourably at ages older than 65.

Deferred annuities

For deferred life annuity products, the proposed assets test is the maximum value of:

- 70% of the purchase price to life expectancy and then 35% thereafter,
- The value of the lump sum amount that is payable if a person withdraws from the product,
- The highest death benefit payable under the product.

We agree with the second and third items above, but are concerned about the first one. The excess of the first item over the maximum of the last two items is an amount that is not available to the member under any circumstances (in the deferral period), assuming there is no access to capital, no commutation (to spouse) or death benefit payable.

The behavioural barriers for members are substantial when it comes to having an assets test on an amount of capital that is not accessible. Moreover, the design of this aspect of the means test **discourages** products with low or zero death and surrender values in the deferral period, which is precisely the design feature that the proposed CIPRs regime was trying to **encourage**.

We agree that if the assets test is reduced in the deferral period, as we propose, it will need to be increased at the point that payments commence.

Other retirement income considerations

We raise one final point, as part of the whole retirement incomes debate, to comment that, using the metric of the present value of total future payments, the Government Actuary's calculations show:

- For a single 65-year-old male home owner, drawing down at the minimum rates, the combined total value of an account based pension with a balance of $600,000 is only $25,000 greater than the value available to a similar member, who had saved an account based pension of $400,000.
- That is, due to the operation of the current means test, an extra $200,000 saved in superannuation results in an additional benefit of $25,000.
- Similarly, for a married couple, an extra $400,000 saved ($800,000 versus $400,000) results in an increase in benefit of $100,000.

These anomalies are outside the scope of the position paper, but we suggest that DSS reviews the overall operation of the means test and the impact of the taper settings, as they appear to be penalising those middle-income savings groups, which are not totally dependent on the Age Pension, but which are below full self-funding. We encourage some consideration to the changed savings incentives on the grounds of inter-group equity.

5 Summary

In summary, we consider that the 70/35 structure should be reduced to a lower level. We also consider that the assets test in the deferral period should be reduced to the greater of the death benefit and withdrawal benefit, with a corresponding increase in the assets test at the date on which payments commence.

We wish to express our appreciation for DSS releasing the Government Actuary's calculations, and subsequent disclosure of the assumptions used. This has enabled industry participants to gain an insight into the reasons behind the proposals put forward by DSS, and helped participants to start their analysis from a common starting point.