Retirement Essentials

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The Secretary
Department of Social Services

By email: RetirementIncomeStreams@dss.gov.au

Dear Madam

Re: Submission re Proposed Means Test Rules for Lifetime Retirement Income Streams

We are pleased to provide our submission into your RIS process and look forward to further engagement in your consideration of this important policy consideration for everyday Australians.

Regards

Paul Rogan
Founder and CEO

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Means Test Rules for Lifetime Retirement Income Streams

Retirement Essentials is a fintech firm with expertise in assisting people who are transitioning to or are in retirement. Our members are everyday Australians, for whom the traditional financial advice process is perceived as being too expensive, complicated and intimidating.

We provide our members with affordable services designed to help them understand their options to fund their retirement. This includes an offer to help them apply for and keep their age pension.

We believe all Australians should have an unbiased choice of how they source their retirement income and our solutions are product agnostic.

Our membership

The focus of this submission is the impact of the proposed changes on our members, who typically have superannuation balances closer to the median, estimated to be $206,194[1] for households with persons aged between 65 and 69 years.

Retirement needs of our members

We have conducted broad research with consumers to determine their needs in retirement. Our research reveals they have a strong desire for regular income; they want to know that their essential expenses are covered by reliable income sources. In the circumstances of our members a substantial proportion of these costs will be met by the Age Pension which often only goes part way to supporting what they consider to be their 'safety net'.

The need for regular income is often complicated by the fact that many do not want to see their superannuation balance fall (they see this as failure). They are aware that their savings are finite and are fearful of running out of money. Our experience is consistent with CSIRO's 2016 study that showed that most retirees in their 60s and 70s draw down on their account-based pensions at modest rates, close to the minimum amounts each year[2]. For many this means they will unnecessarily sacrifice their standard of living in retirement by keeping as much as possible in their accounts. In many cases this results in superannuation balances being bequeathed to their dependents upon their death.

We note the Murray Financial Systems Inquiry determined that the purpose of super did not include bequest motives, a recommendation which has subsequently been adopted by the current government.

An allocation to a pooled lifetime product can be exceptionally useful for many of our members. It provides certainty that their essential expenses are catered for, increasing confidence to spend income generated by an account-based pension and therefore increasing their total retirement income.

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[1] Challenger Retirement Income Research, "Looking at super wealth at the household level", October 2016

[2] Sneddon, T et al, "Superannuation drawdown behaviour", JASSA The Finsia Journal of Applied Finance Issue 2 2016, page 42

When are lifetime products purchased?

It is our experience that the decision to purchase a pooled lifetime product does not happen at the point of retirement. Those transitioning to retirement are often uncertain about what to expect. Such decisions are more likely to be made a few years into retirement when consumers have a better appreciation of the costs of their retirement lifestyle.

Therefore, we would recommend that the DSS make available modelling that represents older retirees, for example a starting age of 70 to provide a more comprehensive view of the proposed changes for average Australians.

Modelling from the Position Paper

The most relevant modelling provided in the DSS Position Paper for our members is found on pages 14/15 and 20/21 relating to singles and couples with balances closer to the median referred to above.

The relevant modelling clearly shows that when comparing the outcomes from an account-based income stream with either 100% lifetime annuity or a blended 70/30 portfolio that in both cases:

- The age pension paid will be higher if our members invest solely in an account-based income stream; and
- The total payments (including a death benefit which has value for the retiree's family) will be higher if our members invest solely in an account-based income stream.

Based on the DSS's modelling our members would have a clear disincentive to purchase a pooled lifetime income stream that is secure and provides protection against outliving their savings. Such an allocation will reduce their age pension payments over their lives and leave their beneficiaries with a significantly lower amount. We fail to see how this meets to DSS 'equity principle' between cohorts of retirees. The proposal appears to dis-incentivise those with lower wealth relative to those with higher wealth to take out some form of longevity insurance when those with higher balances are arguably in a better position to afford some self-insurance.

Conclusion

The Position Paper modelling for single and couples with lower super balances shows that under the proposed rules, an allocation to a pooled lifetime product would reduce our average member's age pension and total retirement payments when compared to solely investing into an account-based pension.

We believe this proposal would provide a clear disincentive to our members to acquire a pooled lifetime product as part of their retirement portfolio. Consequently, we believe they will allocate their superannuation assets to an account-based income stream and effectively self-insure for longevity risk. They will take on greater risks in retirement[3] which we fear will lead to poorer retirement outcomes for our members.

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[3] Retirement risk includes longevity risk, sequencing risk and market risk

Recommendations

We recommend that the DSS:

1. Review their proposed means testing for lifetime income streams to ensure neutrality of retirement products and remove the disincentive for many everyday Australians from allocating part or all of their retirement savings to a lifetime income stream product; and

2. Provide modelling of the proposed changes for older Australians to ensure no unintended consequences exist for the age group who are most likely to be purchasing lifetime income streams (currently closer to 70 than 65).