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16 February 2018

Department of Social Services
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Greenway ACT 2900

By email: RetirementIncomeStreams@dss.gov.au

Proposed Means Test Rules for Lifetime Retirement Income Streams

We refer to your Position Paper of 7 February. Rice Warner is pleased to submit our comments for your consideration.

Means test rules for pooled lifetime income streams

The proposed new rules incorporate pooled lifetime income streams into the means test by:

- income testing a fixed percentage of all product payments as income (assessing 70 per cent of payments as income), and
- assets testing a consistent asset value of 70 per cent of the nominal purchase price until life expectancy at purchase, and half that amount (35 per cent) from then on.

While this structure is simple and broadly equitable, we consider that it would be pragmatic to simplify the latter test. While it is possible to hold a table of life expectancies by age and gender for the purposes of assessing the value for the assets test, this will become more complicated in time. Under the proposed arrangements, life expectancy at purchase would need to be recorded for each product. We believe this would be unnecessarily difficult to administer, particularly in cases where people purchase more than one longevity product at different times.

In addition:

- life expectancy tables will be adjusted at least quinquennially, and each set of tables will need to be stored at DSS (and by financial advisers)
- it will be possible to purchase annuities with reversionary spouse benefits. The life expectancy will then be based on two lives and more tables will be required.

We consider this proposal could be simplified by assessing 70% of the nominal purchase price for a flat period (say 20 years for an annuity purchased at 65) rather than assessing 70% until life expectancy at the time of purchase. An alternative is to set a specific age, say age 85, at which the value falls to 35% of the purchase price.

We have undertaken some modelling which suggests that purchasers of immediate lifetime annuity products may receive less Age Pension benefits over their life under these new arrangements.

Assessment of deferred products under proposed rules

Deferred products will have the same assets test assessment as products that commence immediately. Income from the annuity will only be assessed for the income test once payments commence. Under the current rules income is deemed during the deferral period.

We support the intention of continuing to include the deferred annuity in the asset test from the date of purchase. This serves to limit the risk that deferred products be used to maximise age pension payments across retirement.

We agree that it is sensible only to include income from deferred products once payments commence, as this reflects that the product is not providing an income stream to cover living expenses during the deferral period. This exclusion may also encourage further provision of deferred annuity products in MyRetirement products.

Our modelling suggests that not assessing income from annuities during the deferral period could provide a slightly higher actuarial value of the Age Pension over a person's life. On balance, (given the impact from the suite of changes) these changes will likely incentivise the purchase of deferred annuities over the purchase of life annuities.

Assessment of surrender values and death benefits

Where products offer surrender values or death benefits above the limits imposed by the capital access schedule, the asset test will assess the maximum value of:

- the amount determined under the proposed new rules (70 per cent of the purchase price to life expectancy, and then 35 per cent);
- the value of the lump sum amount that is payable if a person withdraws from the product; or
- the highest death benefit payable under the product.

We support the intention to assess products under the proposed arrangements consistent with the capital access schedule. One of the consequences of the formula is that longevity products without death or surrender values will be treated more favourably for means testing. Further, removal of a death/surrender value will also increase the payments made under these contracts, which is a desirable outcome.

Assessment of account based pension income streams

Assessment of account based pension income streams will not change. We support this decision as we see no reason to alter the treatment of account based pension income streams as part of these proposed changes.

Modelling

The Australian Government Actuary provided the hypothetical 'cameo' projections of retirement income and age pension outcomes included in the position paper. The cameos included below compare the Age Pension outcomes under the current and proposed means testing arrangements for:

- A 65-year-old single, male homeowner with $400,000 assets who allocates 30% to a lifetime annuity and 70% to an account based pension income stream.
- A 65-year-old single, male homeowner with $400,000 in assets who allocates 30% of their assets to a deferred annuity and 70% to an account based pension income stream. It is assumed that the person starts their deferred annuity at age 85 and draws down their account based pension to zero by that age.

Results indicate that the new means testing arrangements may decrease the actuarial present value of the Age Pension for a person purchasing an immediate lifetime annuity, but increase the actuarial present value of the age pension for a person purchasing a deferred annuity.

Assumptions used to produce this modelling are included in Appendix A. Assumptions used were consistent with those provided by the Australian Government Actuary wherever possible.

Modelling of lifetime annuity

Graph 1 below compares the cashflows provided by the Age Pension (in 2017 dollars) under the new and proposed arrangements for a 65-year old single, male homeowner who has $400,000 in assets and allocates 30% to a lifetime annuity and 70% to an account based pension income stream making legislated minimum payments.

Graph 1: Age pension payments - $400,000 assets – 30% LA/70% account based pension (2017 dollars)

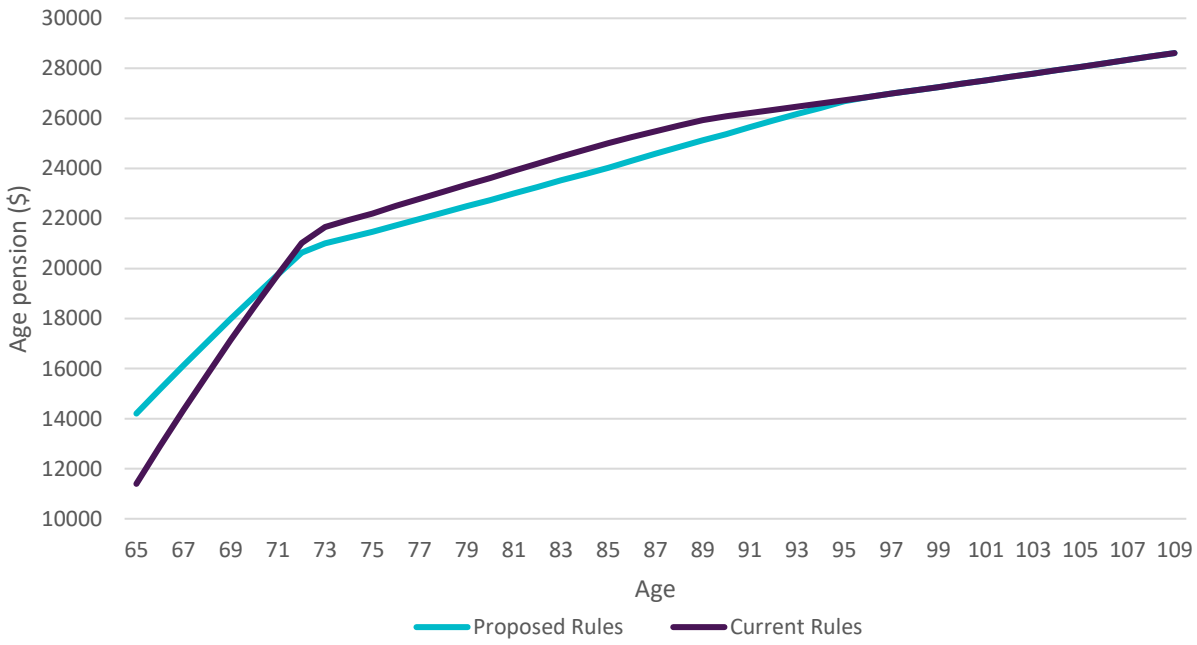


Table 1 below compares the actuarial present value of the age pension under the new and proposed arrangements. The proposed arrangements in this case lead to a lower actuarial present value of the Age Pension. The results are in 2017 dollars and use the AGA 2010/12 life tables.

Table 1: Actuarial present value of the age pension

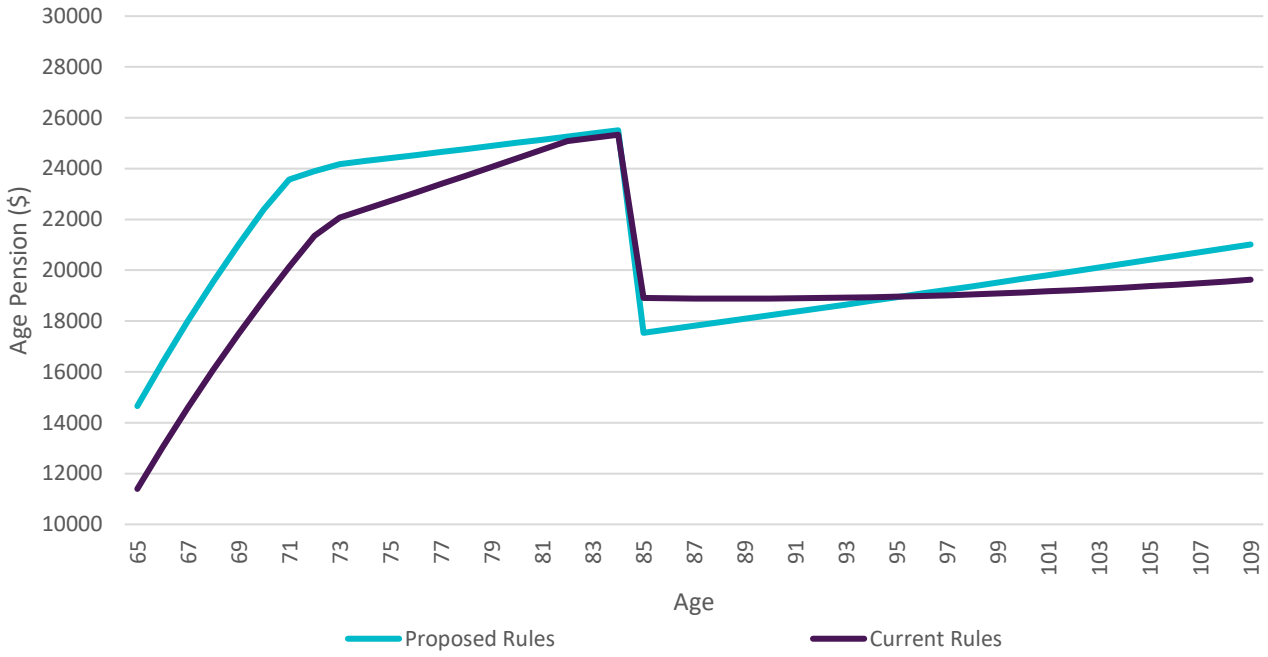
Current rules -30/70 Immediate annuity ($)	Proposed Rules- 30/70 Immediate annuity ($)
438,976	437,621

Modelling of deferred annuity

Graph 2 below compares the cashflows provided by the age pension under the new and proposed arrangements for a 65-year-old single, male homeowner who has $400,000 in assets and allocates 30% to a deferred annuity (starting at age 85) and 70% to an account based pension stream.

The cameo modelling the deferred life annuity assumes that the individual draws down their account based pension income stream to zero by age 85 in such a way that maximises their age pension outcome.

Graph 2: Present value of age pension payments $400,000 assets - 30% DLA/70% account based pension



The table below compares the actuarial present value of the Age Pension under the current and proposed rules. The decision to exclude income from means testing during the deferral period has resulted in a higher actuarial present value under the proposed rules.

Table 2: Actuarial value of the age pension

Current rules - 30/70 Deferred annuity ($)	Proposed Rules -30/70 Deferred annuity ($)
420,501	453,132

Under this scenario, the actuarial value of the age pension is higher under the proposed arrangements.

Conclusions

We are generally supportive of the intention of the proposed changes to properly consider the diverse range of retirement income products that will be developed in the coming years.

We suggest that the treatment of these products could be simplified assessing assets at 70% of their value for a specified period after purchase (say 20 years for a person who purchases an annuity at age 65), rather than at the period up until life expectancy as at the date of purchase.

Our own modelling suggests that the proposed changes could reduce the actuarial value of the Age Pension for those purchasing a life annuity product.

However, the actuarial value of the Age Pension could increase for those purchasing a deferred annuity. On balance, making deferred annuities relatively more attractive will support the development of products for the Government's MyRetirement framework.

Yours sincerely

Michael Rice
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Appendix A – Modelling Assumptions

Key Assumptions	Value (%)
Real Discount Rate/ Real Earning Rate	3.3
Inflation	2.5
Age Pension Indexation	3
Mortality	ALT 2010-12 w/ 25-year Imp. factors
Inflation Indexed Immediate Life Annuity Price (bought at 65)	4.7
Inflation Indexed Deferred Life Annuity Price (bought at 65, 20 years deferral)	25

Note: For immediate products, the account based pension income stream component is the minimum drawdown amount. For the deferred products, the account based pension income stream component is assumed to be drawn to zero by age 85 in such a way that will maximise retirement income before age 85.

Age Pension Means Tests Thresholds and rates

	Single	Couple
	($)	
Maximum Annual Rate	23,254	35,058

Asset Tests

	Homeowner		Non-homeowner	
	Single	Couple	Single	Couple
	($)			
Free Area Threshold	253,750	380,500	456,750	583,500
Cut Out	551,883	829,967	754,883	1,032,967
Taper	$3 per fortnight for every $1,000 above the relevant free area			

Income Test

	Single	Couple
	($)	
Annual	4,368	7,800
Cut Out	50,877	77,917
Taper	50%	

Deeming

	Single	Couple
	($)	
Thresholds	$50,200	$83,400
Rate – Below threshold	1.75%	
Rate – Above threshold	3.25%	