Association of Independent Retirees (A.I.R.) Limited
ACN 102 164 385

Review of Retirement Income Stream Regulations in Superannuation

Submission in Response to Discussion Paper

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The Association of Independent Retirees (A.I.R.) Limited is the peak body representing the interests of retirees who are wholly or partly self-funded in retirement.

We commend the Government in addressing the need for changes to the drawdown phase of Superannuation and look forward to changes to give more streamlined regulations for account based pensions and transition to retirement pensions and to more relevant and appropriate income stream products being available in Australia.

We also support the need for change to assist all Australians' who self-fund their retirement, to better manage the financial, lifestyle, longevity and other risks faced in retirement and to reduce the cost of superannuation fund management fees in the drawdown phase.

Founded in 1990, A.I.R. is member driven, not-for-profit, non-political, volunteer organisation who work to advance and protect the interests and independent lifestyle of Australians in retirement. Our goal is to *secure recognition and equity for Australians who, through their diligence and careful management, fully or partly self-fund their own retirement needs*

This submission reflects the views of A.I.R. members who have experience in managing their affairs in retirement and as such have a clear understanding of the issues that affect them and have provided pragmatic and realistic advice relating to this submission into the review of the retirement income stream regulations in Australia.

Should you require any further specific information in relation to this submission, please contact A.I.R. Policy Director, Robert Curley, as follows:

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Yours sincerely

Max R Barton
National President

Summary of the Proposed A.I.R. Recommendations

- Prescribed minimum drawdown payments:
  - Should not be age related.
  - Should preserve the real value of the fund at retirement during the life of the fund member.
  - Should allow compulsory superannuation contributions less the contribution tax to be added to an existing pension (we do appreciate that this may impact on the purchase price and purchase date of the account based pension but it does simplify the problem of setting up a new superannuation account / accounts for the compulsory superannuation contributions when, after retiring, one rejoins the workforce).
  - Should be set at a defined minimum value that equals drawdown of the real earnings of the pension asset (6% return less CPI of 2.5% equals 3.5%).

- Guaranteed Income Stream Products (GISP):
  - The prescribed minimum payment for all products should be the same as for account-based pensions.
  - There should be no restrictions on the term of a product, variations in annual payments, residual capital value, or commutation value of any GISP.
  - Hybrid products should be encouraged.
  - If desired by the product developer, a guaranteed product should be able to allow supplementary amounts to be added.
  - If desired by the product developer, death benefits should be allowed to be incorporated into a GISP.
  - The rate and variability of pension payments should be consistent with the part of the definition of a pension that requires payment at least once per year; no further restrictions should be prescribed.
  - As a consequence of prescribing a non-age dependent rate for the prescribed minimum payment, indexation arrangements should not be prescribed. Benefit flowing from periods of better return will be balanced over the long term by periods of lower return.
  - The Government should not attempt to prescribe restrictions arising from variability in return.

- Deferred Lifetime Annuities (DLA):
  - The design of deferred lifetime annuities (DLA) should allow purchase from superannuation and non-superannuation funds.
  - DLAs should be allowed to be purchased from superannuation and non-superannuation accounts.
  - Earnings from DLA funds during the deferred period should be tax free (but there should be no concessional taxation treatment for other non-account based Guaranteed Income Stream products).
  - Access to DLAs should be no earlier than the purchaser's life expectancy at the time of purchasing the DLA.
  - There should be no maximum age at which one can purchase a DLA.
  - The minimum age at which one can purchase a DLA should be the preservation age ruling at the time of purchase.
  - That there should be no commutation of a DLA.
  - No death benefit should be incorporated into DLAs.
  - There should be no payout for early death for DLAs.
  - DLAs must be paid for in full at time of purchase.
  - The provider should be required to refund the fund earnings from forgone tax income to the Government if the purchaser passes away before his life expectancy age and the commencement of payment of the DLA

Superannuation Retirement Income Regulation Policy

Income from assets supporting a retirement income stream is exempt from tax. The Discussion Paper provides the following background to the purpose of the retirement income stream regulations:

> The Regulations have been developed to ensure that income stream products are used for their intended purpose, ie: providing a regular source of income in retirement. The Annuity and Pension rules are contained in Regulation 1.05 and 1.06 in Part 1A of the Superannuation Industry (Supervision) Regulations 1994.
>
> A basic principle is that an income stream should represent a series of regular payments over the recipient's lifetime or of a fixed term thereof.
>
> The design of the rules aims to:
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> - protect the tax exemption from being used to accumulate or preserve wealth (Estate Planning);
> - allow people choice and flexibility; and
> - ensure that the rules are objective, transparent and as simple as possible to understand.
>
> Regulatory requirements common to all income stream types are:
>
> a. payments must be made from the income stream at least annually (some guaranteed income streams require regular shorter period payments);
> b. there must be a minimum annual payment which is age related;
> c. the capital supporting the income stream cannot be added to by way of contribution or rollover after the income stream has commenced;
> d. the income stream cannot transfer to another person except on death;
> e. the capital value of the income stream and the income from it cannot be used as security for a borrowing.

As a part of our submission we wish to test whether these requirements achieve the design aims.

Changes to Superannuation Policy and Practice since 1994

Since the Regulations were made in 1994 there have been many changes to the retirement phase of superannuation, which affect the relevance and efficacy of the Regulations.

Also since the Global Financial Crisis (GFC) there has been a marked change in the asset structure of the retired population. Over two-thirds of retirees now form a group that receives some form of Government support, either the Age Pension in part or full or the Commonwealth Seniors Health Card (CSHC). Members of this group do not have sufficient funds to fully fund their retirement and to cover their ageing and longevity risks. They have virtually no flexibility to build assets.

A second group have moderate assets sufficient to fully fund their retirement with some flexibility as to the way in which they drawdown their non-superannuation and superannuation assets. The value of the assets of this group has fallen from pre-GFC values.

A third and small group of less than 100,000 persons have a comfortable level of assets. Experience with increasing numbers of people reaching retirement age, living longer, experiencing marked turbulence in investment markets, and drawing down superannuation assets has highlighted the issues of investment risk, ageing health risk, and longevity risk.

The assumption in establishing the 1994 Regulations, that retirees should be required to run down their superannuation assets before their death no longer holds as a longer life creates unexpected and increasing costs well beyond CPI of health and aged care, and supply of services such as local rates, water, gas and electricity and insurance. These changes are not of a short term temporary nature.

Government policy remains the three pillar system of retirement saving. The compulsory superannuation component forces people to save but to carry the saving risks. To partially offset these risks the Government has provided some taxation concessions but has established Regulations to protect these concessions.

This submission responds to the Review of Retirement Income Stream Regulation.

Superannuation Regulations should:

1. Recognise that the retirement community is not a homogeneous community. The vast majority of retirees fall within the two groups described above that do not have surplus assets or income above their needs appropriate to their accustomed community standard of living.
2. Encourage individuals to manage their superannuation funds to cover their investment, ageing and longevity risks, including maintaining living, transport and housing needs, and managing increasing health and aged care costs.
3. Recognise that efficient management of ageing and longevity risks requires that some superannuation assets must be maintained until death to cover unexpected events. Consequently, the efficient management of these risks implies that some superannuation assets will pass to beneficiaries of the Estate. The focus for the majority of retirees is not on maximising Estate Planning but is on managing ageing and longevity risks to ensure security in old age.
4. Recognise that ageing requires an individual to manage income, health and accommodation as an integral process. Existing regulations are not rationalised across these services causing inefficiencies. For example, there are a number of different methods of calculating assets and benchmarks for the purpose of entitlement to services. A common and transparent method should be adopted for determining the right to all ageing services, whether income, health or ageing.
5. Not impose age-related minimum drawdown payments that will (a) force people eventually onto the uniform standard of living as defined for the full Age Pension safety net; or (b) increase the net cost to Government in increased Age Pensions; or (c) reduce individual incentive to self-manage ageing and longevity risks.
6. Compulsory superannuation was introduced for all age groups in 2010, including retirement age groups. It is in the interest of the Government and many retirees to continue to work. Regulation 1.06 prevents additional superannuation income from being added to an existing pension. However, there is nothing in the Regulations, nor should there be, to prevent a retiree undertaking work and receiving a compulsory superannuation payment from commencing a new pension. If the work includes a regular superannuation payment, then an individual wishing to draw down the superannuation payment may have to establish a number of pensions. The Regulation does not achieve the purpose for which it was intended in 1994. It simply adds fees and complexity for the establishment of new pensions.

Addressing the Questions in the Discussion Paper

Minimum Payment Amounts for Account-Based Streams

Section 3 of the discussion paper (Questions 12 to 16)

This issue is addressed first in this submission because the recommendations and responses to the questions in this Section impact on the questions in Sections 1 and 2 (Income Stream Products).

Minimum annual payments are increased from 4% for people under age 65 to 14% for people aged 95 or above. They were introduced in 2007 to replace previous minimum and maximum payment limits.

As discussed earlier in the submission, over two thirds of retirees are full or part Age Pensioners or of moderate means.

Chart 1 in the Discussion Paper is based on a long term investment return of 6% per annum and a CPI increase of 2.5%.

This indicates that a single retiree would need a superannuation asset of $1.37 million on this investment scenario to avoid receiving a part pension, or $1.43 million to be excluded from CSHC eligibility. Most retirees are full or part Age Pensioners. Retirees with superannuation assets (and private assets) with assets above $2 million are very small in number. Personal income tax payments show that of the order of 200,000 people over 65 years may be classed in a reasonably wealthy category compared to over 2.5 million full or part Age Pensioners, CSHC holders or people with only moderate asset levels.

The minimum payment rules are acknowledged to detrimentally affect people who are less well-off (*Discussion Paper Para 71*) - the majority of retirees as described above. The ability to increase assets for estate planning purposes for these retirees is negligible. There is clear evidence that the retirement income needs of people as they age do not decrease in real terms, but they change. Peoples' deepest fears are that they will not have enough retirement income and assets to face the uncertainties of economic disasters and of personal events including health and ageing costs. They have a very basic need to preserve any assets they have acquired, including superannuation they have been fortunate enough to accumulate.

Table 1 below, based on the same returns as Chart 1, demonstrates that the income from a superannuation asset of $200,000 at age 60 remains roughly constant up to age 95 because of the increasing minimum payment rate. This table shows that the net real income declines significantly above age 95 because of the reduction in assets arising from increasing prescribed minimum payment rates. Above age 95 the cost to Government in increased Age Pension increases to the full Age Pension level and the amount of superannuation income declines significantly to a real value of $4,718 - totally inadequate to allow for unexpected health and ageing costs.

Table 1: Effect of minimum payments for part pensioners (Initial Asset $200,000)

Age	Real Age Pension Received	Superannuation income	Net real income
70	$19,358	$9,271	$28,629
84	$19,531	$8,925	$28,456
95	$19,770	$8,445	$28,215
100	$21,624*	$4,718	$26,342

Table 2 below demonstrates that people have lost virtually all of their superannuation assets (85.5%) by age 100. Present prescribed minimum annual drawdown payments decimate peoples' superannuation assets and income later in life when uncertainty is at a high point.

Further, the loss of superannuation asset is far greater than any cost to Government of setting a minimum drawdown level equal to average earnings in the fund over the long term. This level maintains the commencing retirement asset in real terms over the life of the retiree and enables retirees to better manage the longevity risk of outliving one's retirement savings as has occurred with the current minimum % drawdown rates.

This also shows the reduction in superannuation real asset using present prescribed minimum payment rates compared to cost to Government in maintaining the real value of the asset for individuals who do not have additional private investments.

Table 2 Effect of fund size on Assets and Cost to Government

Initial Asset[1]	Asset At 100[2]	Loss of Asset[3]	Govt cost[4]	Govt cost[5]
$1,000,000	$144,923	85.5%	$161,181	16.1%
$500,000	$72,461	85.5%	$88,250	17.7%
$200,000	$28,985	85.5%	$28,594	14.3%

Notes:

1. Initial Asset is the superannuation retirement asset at age 60.
2. The remainder of the Initial Asset at age 100 in real terms using present prescribed minimum drawdown rates.
3. The percentage loss of the Initial Asset at age 100 in real terms using present prescribed minimum drawdown rates.
4. The estimated cost in increased Age Pension from age 60 to age 100 of maintaining the real value of the initial asset.
5. The percentage cost in increased Age Pension from age 60 to age 100 of maintaining the real value of the Asset to age 100.

Present prescribed minimum payments:

1. Effectively remove peoples' superannuation assets and income later in life when uncertainty is at a very high point. People's deepest fears are that they will not have enough retirement income and assets to face the uncertainties of economic disasters, and of personal events including health and ageing costs. The majority of retirees are full or part Age Pensioners. Their only significant assets are their home and their superannuation assets. Their superannuation asset has been built with the expectation that they will have it available as their main source of income in retirement. Removing this is the worst possible step that a Government can take.
2. Have the expectation that people will invest the withdrawn assets and pay personal income tax. It is well known that the majority of retirees do not have the interest or expertise to invest savings themselves. Their only avenue is to bank such savings with poor, although secure, returns. Forcibly removing superannuation assets through a prescribed minimum payment greater than the superannuation fund earning rate simply places these assets in a low return environment, detrimental to longevity risk needs. In addition, building funds forced from superannuation is not attractive to full or part Age Pensioners because they lose up to half of the income in reduction in their Age Pension.
3. Reduce the superannuation asset from forced age-based minimum payments at a far greater level than the cost to Government of maintaining the real value of the asset. Maintaining the real value of the asset reduces markedly the deep fears that retirees have to face uncertainty. Retirees understand that the purpose of superannuation is to assist in maintaining their income. They understand the reasonableness of a policy to require their superannuation asset earnings to be withdrawn to meet their living costs but do not understand the rationale of Government is forcing them out of superannuation after they have spent a lifetime building it with the Governments encouragement.
4. Force people down to the safety net level of the Age Pension and Government incurs increasing Age Pension payments for all retirees beyond about the age of 90. Maintaining the real value of the superannuation asset provides the ability for people to maintain a reasonable standard of living and meet uncertain costs. They are not building estate planning assets.
5. Are inconsistent with the deferred annuity model proposed in the Discussion Paper. There is something inconsistent about the proposition that people should be encouraged to purchase deferred annuity products when the Government has effectively reduced their superannuation asset to an insignificant level.

The Association is strongly of the view that the Government should not interfere in the way an individual draws down superannuation assets against the use of non-superannuation assets. These are personal decisions affected by many factors including downsizing of the home and aged care accommodation. The responsibility of Government is not to minimise superannuation concessions, but to minimise the risks forced on retirees by the compulsory superannuation system. The above explains why people have been deeply concerned with the present prescribed minimum payment system. It explains why people pressed so hard for reduction in the rates during and after the Global Financial Crisis.

The Government has steadily reduced the size of contribution caps as a means of reducing the maximum size of the superannuation asset that can be established by an individual. Consequently, it would be expected that the maximum level of superannuation asset will consolidate at a level less than the few very high multi-million dollar asset levels at present. The Association believes that managing input levels is a more appropriate basis for managing superannuation asset levels than prescribing minimum superannuation withdrawal levels that force reduction in superannuation assets for all income levels and increase the critical concern of retirees that they will be unable to manage their retirement financial needs.

The Association recommends that the minimum annual drawdown pension payment should be set to maintain the superannuation asset in real terms. Using the return of 6% and a CPI of 2.5%, on which Chart 1 is based, the minimum payment should be set at 3.5% for all ages to retain the real value of the superannuation asset.

The prescribed minimum payment percentages were reduced during the Global Financial Crisis in recognition of the need to maintain assets to counter increased longevity risk. The Association believes that if its recommendation of a non-age dependent minimum payment rate of 3.5% is accepted, then the need for Government adjustment under financial crises should be lower. However, it recommends that the right of Government to make this adjustment should be retained but only used under extreme circumstances.

Guaranteed Income Stream Products (GISP)

Section 1 of the discussion paper (Questions 1 to 4.)

Any retirement income products that transfer risk from the recipient to the provider will carry a lower income rate to cover the transfer of risk. It follows that, for any given quality of living, the assets required from using income products of this type will need to be significantly greater. Hence, such products can only form a very small proportion of investments for the group with Government pension or CSHC support, the lower return must be balanced by a lower standard of living. They are more likely to form part of the investment portfolio of an individual as the value of total assets increases.

The Association emphasises the need for proper prudential requirements for organisations offering GISPs and takes the view that the recommendations in its response to the issue on prescribed minimum payments from superannuation should be applied equally to GISPs.

With GISPs the Association considers:

- the prescribed minimum payment for all products should be the same as for account-based pensions;
- there should be no restrictions on the term of a product, variations in annual payments, residual capital value, or commutation value of any GISP;
- Hybrid products should be encouraged;
- if desired by the product developer, a guaranteed product should be able to allow supplementary amounts to be added;
- if desired by the product developer, death benefits should be allowed to be incorporated into a GISP;
- the rate and variability of pension payments should be consistent with the part of the definition of a pension that requires payment at least once per year, no further restrictions should be prescribed;
- as a consequence of prescribing a non-age dependent rate for the prescribed minimum payment, indexation arrangements should not be prescribed. Benefit flowing from periods of better return will be balanced over the long term by periods of lower return;
- the Government should not attempt to prescribe restrictions arising from variability in return.

Deferred Lifetime Annuities (DLA)

Section 2 of the discussion paper (questions 5 to 11)

The Association supports the development of Deferred Lifetime Annuities (DLA) and with the design of deferred lifetime annuities (DLA) they should be allowed to be purchased from superannuation and non-superannuation funds.

With DLA's the Association considers:

- earnings from funds invested during the deferred period should be tax free;
- access to DLA funds should be no earlier than the life expectancy definitions;
- DLAs should be allowed to be purchased from superannuation and non-superannuation accounts;
- earnings from DLA funds during the deferred period should be tax free (but there should be no concessional taxation treatment for other non-account based Guaranteed Income Stream products);
- access to DLAs should be no earlier than the purchasers life expectancy at the time of purchasing the DLA;
- there should be no maximum age at which one can purchase a DLA;
- the minimum age at which one can purchase a DLA should be the preservation age ruling at the time of purchase;
- that there should be no commutation of a DLA;
- no death benefit should be incorporated into DLAs;
- no payout for early death for DLAs;
- DLAs must be paid for in full at time of purchase;
- the provider should be required to refund the fund earnings from forgone tax income to the Government if the purchaser passes away before his life expectancy age and the commencement of payment of the DLA.

Other Issues

Finally some Association members have suggested that this Discussion Paper should have also included a review and a question on a cap on the maximum amount of capital in account-based pensions which either couples or singles may have.

Within our Association we have an in-principle agreement to the idea of a cap by either:

1. limiting the maximum value of assets in account-based pensions for either couples or singles; or
2. increasing the minimum annual drawdown percentage above our recommendation in this submission where the determined cap of the asset value is exceeded.

However, we see issues with how would such a cap be determined that is both equitable and realistic. At what age is it applied? Is the cap subject to indexation? Is it limited to just account-based pensions and annuities purchased from superannuation accounts?

We also accept that over recent years the Government has initiated a strategy to limit the total value in an individual's superannuation account via contribution cap limit.

The other issue the Association considers exists is with the type of irregularities reported that there are couples with superannuation accounts with a total of >$10 million of assets. Our Association's recommendation is that there should be a regulation to limit this type of irregularities with the purchase of an income stream product such as account-based pension or an annuity purchased from superannuation accounts.

End of Submission

Enquiries about the content of this submission should be directed to A.I.R. Policy Director, Robert Curley:

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