Australian Government
Department of Social Services

Social Services and Other Legislation Amendment (Supporting Retirement Incomes) Bill 2018

Submission to Senate Economics Legislation Committee

January 2019

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Introduction

The 2018-19 Budget announced measures that aim to boost Australians' confidence in their long-term financial security. This included new means test rules for lifetime income streams, an increase and extension of the Pension Work Bonus, and the expansion of the Pension Loans Scheme.

A Bill incorporating these measures, the Social Services and Other Legislation Amendment (Supporting Retirement Incomes) Bill 2018, was introduced into Parliament on 29 November 2019 by the Minister for Families and Social Services, the Hon Paul Fletcher MP.

Schedule 1 – Lifetime Income Streams

Background

New superannuation regulations relating to lifetime income streams took effect on 1 July 2017

The 2016-17 Budget announced new superannuation regulations to facilitate innovative lifetime retirement income stream products and address issues that restricted the ability of retirement income providers to develop and bring new retirement income stream products to market.

These new regulations took effect from 1 July 2017, and set out new income stream standards in the *Superannuation Industry (Supervision) Regulations 1994* (SIS Regulations). They provide design rules for lifetime superannuation income streams that will enable retirees to manage consumption and longevity risks in retirement. The overarching goal of the regulations is to provide flexibility in the design of income stream products to meet consumer preferences while ensuring income is provided throughout retirement.

The products facilitated by the new regulations allow people to invest in products that pool their savings with those of others to secure lifetime payments. By pooling people's savings, these products can provide protection against longevity risk (an individual's risk of outliving their savings). This is because a portion of people's investment in the pool goes to support payments to other members upon death.

These products will provide payments for a person's lifetime, and sometimes also their partner's lifetime. The regulations also anticipate ***deferred products*** that start making payments to a person once they reach a certain age (for example, age 85).

Lifetime products offered under the new superannuation regulations are required to satisfy a declining ***capital access schedule***. This schedule limits the proportion of the initial purchase price that may be returned as a ***surrender value*** (the lump sum available if a person commutes the product) or paid as a ***death benefit***. Products offered under the new regulations allow no access to capital after a person reaches their life expectancy (at age 65 this is around 19 years for males and 22 years for females). This requires people to relinquish access to the capital to support pooling.

It is anticipated that the new regulations will facilitate the provision of new retirement income products within the superannuation environment. This will include products that defer making payments until a specified age. It also includes products such as investment-linked pensions and annuities, and group self-annuitised products, where income payments will vary from year to year depending on investment and mortality experience.

A range of innovative products are expected to emerge over time, including products of a more complex and hybrid nature.

Government retirement income policy, such as the Retirement Income Covenant announced at the 2018-19 Budget, may drive the development and purchase of lifetime income stream products. The proposed Retirement Income Covenant requires superannuation trustees to offer a Comprehensive Income Product for Retirement. Such a product is likely to include a lifetime income stream.

Lifetime products continue to be offered under other superannuation regulations or may also be purchased outside of the superannuation system using non-superannuation monies. These products would not be required to satisfy the limits on surrender values and death benefits prescribed by the new superannuation regulations.

The social security means test

Australia's social security system uses means testing to ensure payments are targeted to those people who are most in need. In order to keep the social security system sustainable, Australians are expected to use their own resources before calling on the support of the general community. The social security means test withdraws income support as a person's capacity to support themselves increases. All income support payments, apart from Age and Disability Support Pensions paid to people who are blind, are subject to a means test that ensures both income and assets at the disposal of an applicant for a payment are taken into account.

The means test is an important feature of the pension system. For most of its 100-year history, Australia's social security system has used means testing to help keep the system fair and properly targeted to those most in need. The tests are kept under review to ensure they are meeting the requirements of the community for well-targeted income support.

Social security and Veterans' Affairs payments, including the Age Pension, are subject to both an income and an assets test. A person's entitlement to an income support payment is assessed under both tests, with the test that produces the lower amount determining their rate of payment.

The income and assets tests for social security and Veterans' Affairs pension payments have 'free areas' that mean that pensioners can have certain levels of income or assets without affecting their pension. Withdrawal or 'taper rates' apply to income and assets over the free areas so that as the amount of a person's income and assets increase, their pension is progressively reduced.

The ***income test*** takes into account income that a person has from all sources, including employment income, superannuation income and deemed income from financial investments. The income test is designed to target social security assistance and encourage people to supplement their income support payments with other income, if they are able to do so. Income over the income free area reduces the rate of pension payable by 50 cents in the dollar for singles, and 25 cents in the dollar each for couples. As at 1 July 2018, the income free areas for pension payments are $172 per fortnight for singles, and $304 per fortnight for couples (combined).

The ***assets test*** captures wealth, including superannuation assets and non-income producing assets (for example, holiday houses) and therefore ensures that people do not obtain a pension advantage from moving their wealth into assets that do not form part of the income test. Assets over the assets free areas reduce the rate of pension payable by $3 for every $1,000 in assets, for both singles and couples. As at 1 July 2018, these asset free areas are:

- $258,500 for single home owners;
- $387,500 for couple home owners (combined);
- $465,500 for single non-home owners; and
- $594,500 for couple non-home owners (combined).[1]

As a general rule, the income test is more likely to apply to pensioners with modest investment holdings or income from earnings, foreign pensions or defined benefit income streams, whereas the assets test is more likely to apply to pensioners with more substantial investment holdings or other significant assets.

Income streams under the means test

Income streams held by social security recipients are assessed under both the income and the assets test. There are currently four main categories of income streams under the *Social Security Act 1991* and the *Veterans' Entitlements Act 1986*: account-based income streams, asset-test exempt income streams, short-term income streams, and long-term income streams.

[1] For allowance payments, such as Newstart Allowance, a person is ineligible for payment if they have assessable assets above the relevant threshold. Allowance payments are an income support safety net for working age Australians. The difference between pension payments and allowances reflects the fact that allowances (which are paid to people of workforce age) are designed to include incentives for people to join or return to the workforce, while pensions acknowledge that some people face barriers such as age or disability while trying to support themselves.

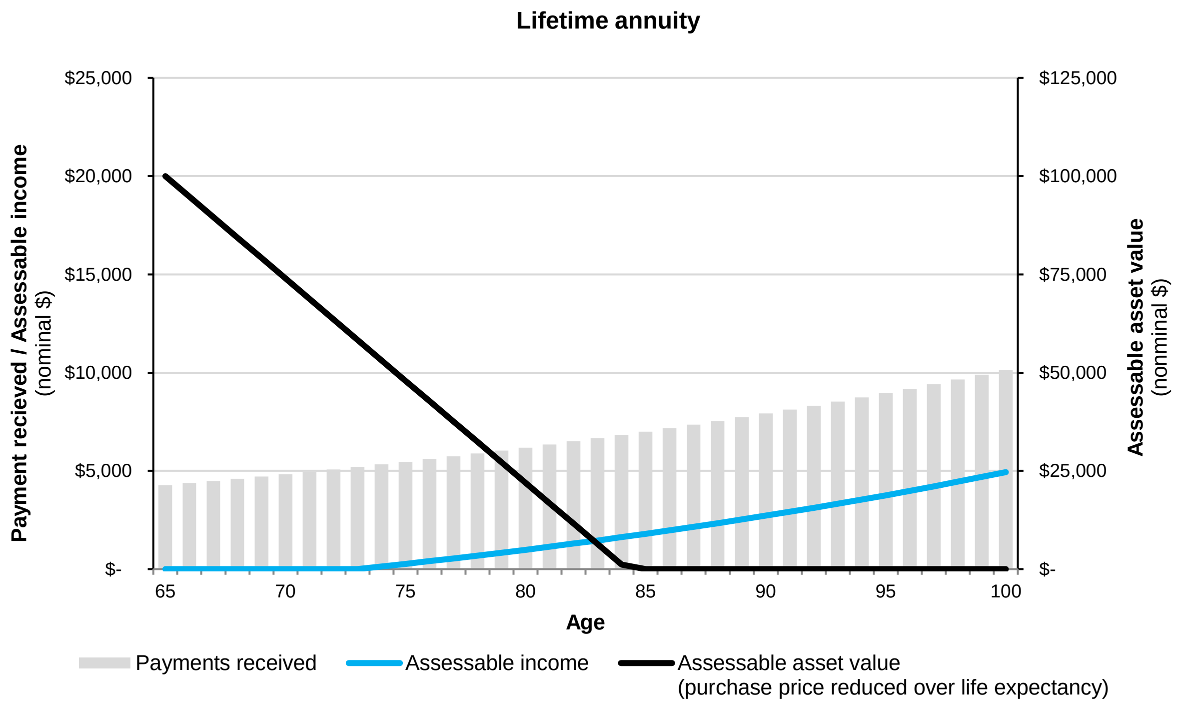
SCHEDULE 1 – LIFETIME INCOME STREAMS

Lifetime income streams held by social security recipients are currently assessed under the rules for long-term income streams.

- Under the ***income test***, a deduction amount approach is used. This approach assesses the annual payments made by the product, less a deduction amount. This deduction amount is different for each product. For lifetime income stream products, the deduction amount is calculated by dividing the purchase price by the purchaser's life expectancy.
- Under the ***assets test***, a capital reduction approach is used. This approach assesses the purchase price in the first year, and then reduces the amount assessed over a specified period of time. Where the products have a residual capital value, this amount continues to be assessed. For lifetime income stream products, the initial purchase price is reduced over a period from purchase until a person reaches their life expectancy (at the time of purchase).[2]

To illustrate the current rules, Chart 1 shows the current treatment of a lifetime annuity with an initial purchase price of $100,000 established at age 65.

Chart 1: Current income and assets test assessment for lifetime annuity[3]



[2] This is determined at the age at which they bought the product using the relevant Australian Government Actuary's Life Tables. Some lifetime income streams also allow for a remaining partner to receive a reversionary payment should they live longer than their partner.

[3] Lifetime annuity assumes purchase by a 65 year old male. Payments are indexed to inflation annually, with the purchaser receiving a payment of $4,272 in the first year.

Rationale

The following principles have been used to guide the development of new means test rules for lifetime income streams. These principles reflect the longstanding policy framework underpinning means testing within Australia's social security system.

- ***Neutrality.*** The means test assessment should not advantage a particular type of product or provide an incentive for people to invest in a particular asset as a result of it receiving a more favourable means test treatment.
- ***Equity.*** The rules should treat people with similar means in a consistent way, and those who have a greater capacity to self-provide for their retirement should receive lower income support.
- ***Resilience.*** The rules should be able to apply to a range of products, including new products, without diminishing neutrality and equity. This will enable income stream providers to be innovative, and minimise the need for further changes to the rules as new types of products emerge.
- ***Integrity.*** The rules should ensure the social security system remains targeted to assisting those most in need of support, and that people cannot seek to exploit the means test rules to maximise their income support.
- ***Fiscal sustainability.*** The means test treatment of new retirement income stream products should have regard to the cost of the social security system.
- ***Simplicity.*** The rules should be easy to understand for income support recipients, financial advisors and income stream providers. Complicated rules can result in people making poor financial decisions. Simple rules support people to make good decisions.

While the social security means test operates to assess a person's income and assets at a particular point in time, the nature of lifetime income stream products means that it is also important to be mindful of the impact of rules over the longer term. This can highlight situations where the cumulative effect of rules over time may be unfair, risk distorting investment decisions, or subsidise particular choices or bequest motives.

Issues with the current rules

The current rules for lifetime income streams provide an inadequate framework for assessing the diverse range of complex and pooled lifetime products that are expected to emerge as the retirement phase of the superannuation system becomes fully developed. The current rules were designed for simple retirement income products with few additional features or characteristics. The existing rules also have concessional elements that impact the targeting of income support. They were not designed or intended to accommodate market innovations or increasing product complexity and may provide unfair, inconsistent or unduly concessional outcomes if applied to a broader range of retirement income products. This may result in uncertainty for industry and retirees, and risks distorting investment decisions.

SCHEDULE 1 – LIFETIME INCOME STREAMS

Income Test

As a matter of policy, the return of the original capital investment in financial products and other assets have not generally been assessed on the basis that it would be inappropriate to treat these amounts as income. Income stream payments typically consist of the return of the original investment capital over time, plus earnings on that original investment amount and any longevity dividend from the pooling of mortality risk (if any).

The current rules determine the deductible amount for lifetime income streams by attributing the purchase price over the period until a person reaches their life expectancy (at purchase). The payments made by the income stream, less the annual deductible amount, is the amount assessed under the social security income test. The deductible amount continues to apply indefinitely, even after the capital component has been fully returned. This means the cumulative value of deductions can considerably exceed the initial capital investment where people live beyond their life expectancy.

As the deduction amount is fixed it reduces in real terms over time compared to the payments the person receives from the product, which are generally indexed. This suggests that the current rules may not provide a particularly good representation of the return of capital for these products.

Under current income stream pricing, the existing rules often result in almost no income being assessed in the first years of retirement, despite the person having income to use for self-support.

Assets Test

A consequence of the current rules for lifetime income streams is that they are assessed as having no asset value once a person reaches their life expectancy. Such products continue to provide significant payments beyond this point, and are of ongoing value to holders. This value is reflected in the pricing of their initial investment and in the choice of such products to manage retirement income.

This treatment is arguably a very concessional assets test outcome compared to the manner in which other income streams are assessed. In effect it produces a similar assets test outcome to that for a term-certain annuity product providing payments to life expectancy, despite offering payments over a much longer timeframe.

The current rules also produce more concessional assets test outcomes beyond life expectancy than for a similar amount managed in an account-based product with the intention of managing longevity risk.

While people benefit most from these products if they are long-lived, at least half of the population purchasing such products could be anticipated to be benefiting from this concessional treatment beyond life expectancy.

The current definitions used by the means test were not designed to deal with features attached to lifetime income streams, such as death benefits or surrender values. High surrender values and death benefits are not captured under the existing rules, even though they are integral to the value of the product and its ability to be used for self-support. It is important to the equity and neutrality of means test outcomes that product characteristics are fully captured by the rules.

SCHEDULE 1 – LIFETIME INCOME STREAMS

New rules

The new means test rules for lifetime income streams seek to provide a more constant means test assessment across retirement, resulting in more consistent social security outcomes where a person has chosen to use a lifetime product to manage their retirement income. This reflects the lifetime nature of payments provided by these products. It seeks to complement the role of lifetime products in providing more even and consistent retirement incomes across retirement.

Schedule 1 of the Bill establishes these new rules by creating a new category of income stream – asset-tested income stream (lifetime) – to which these new rules apply.

The proposed new rules seek to strike an appropriate lifetime assessment by:

a) ***income testing*** a fixed percentage of all product payments as income (assessing 60 per cent of payments as income), and

b) ***assets testing*** a consistent asset value of 60 per cent of the nominal purchase price for the longer of five years, or until the person reaches the expected age at death of a 65-year-old male (currently age 84) (the threshold day). Half that amount (30 per cent) will be assessed from then on.

Additional provisions have also been included to ensure fair and appropriate outcomes when assessing income streams not restricted by the new superannuation regulations. These are outlined on page 13.

The process for assessing an asset-tested income stream (lifetime) is outlined in Diagram 1.

While the primary focus of the means test is on fairly and sustainably targeting income support to those most in need, the proposed new rules have been developed with an awareness of the need for means testing arrangements to be appropriate for lifetime products and support broader retirement income policy objectives.

The proposed income and assets parameters were designed to ensure that the new rules do not unfairly disadvantage people who choose to make use of a pooled lifetime product. They have been developed with a strong focus on their impact on people's ***total retirement income*** – that is, the combination of income from lifetime products, other retirement savings and the Age Pension. They are intended to be sustainable and appropriate for a range of retirement scenarios, involving different levels of retirement savings.

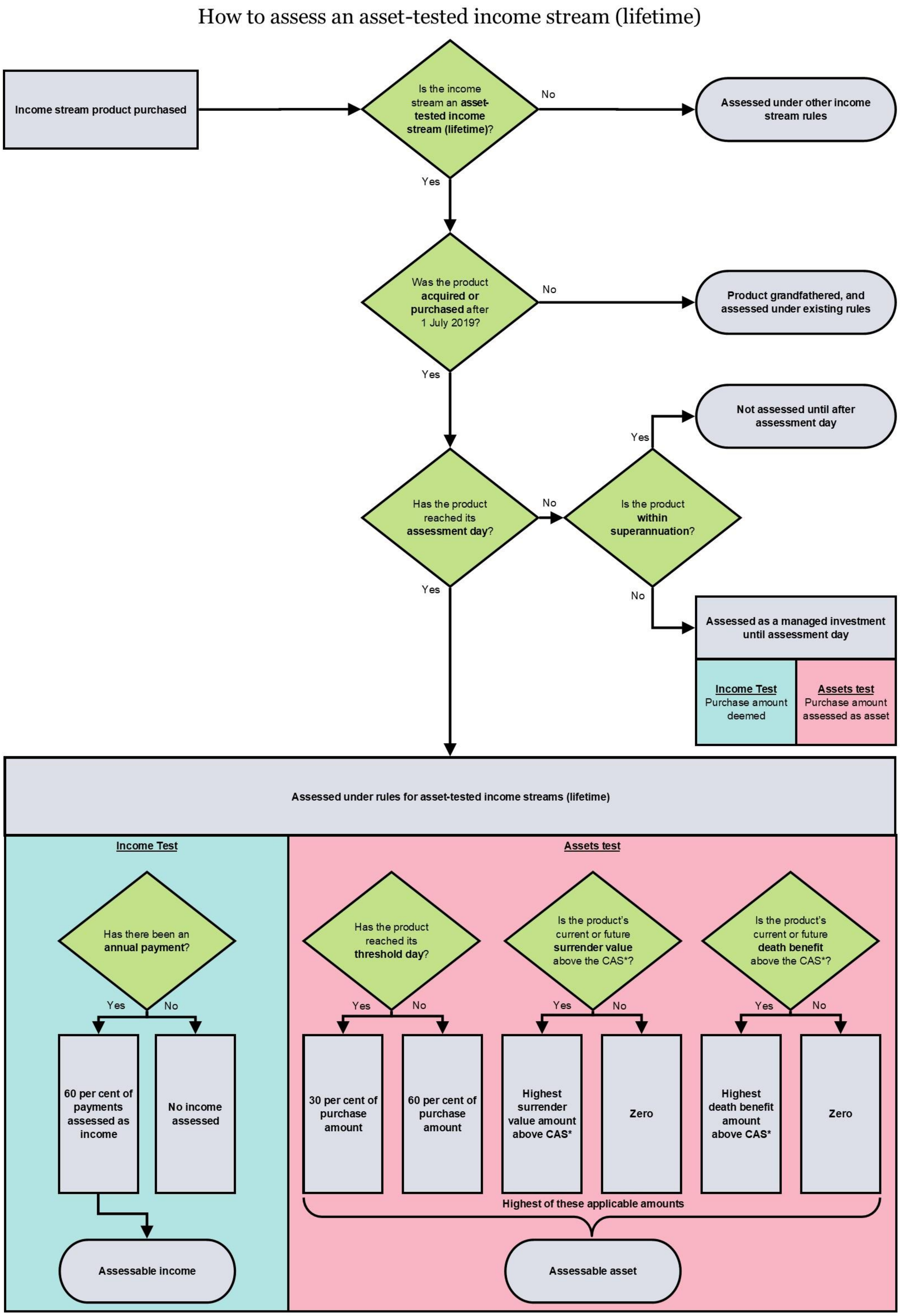
Assessing fixed proportions under the income and assets tests over the duration of a lifetime income stream produces more consistent Age Pension outcomes over time. This supports broader retirement income policy objectives, including helping retirees plan for a consistent level of income across retirement.

Income Test

Assessing a fixed proportion of product payments as income for the purposes of the income test recognises the focus of lifetime products upon providing a consistent planned source of income across retirement, providing a similarly consistent means test assessment. This supports broader retirement income policy objectives.

SCHEDULE 1 – LIFETIME INCOME STREAMS

Diagram 1: Flow Chart – How to assess an asset-tested income stream (lifetime)



*CAS = Capital Access Schedule

SCHEDULE 1 – LIFETIME INCOME STREAMS

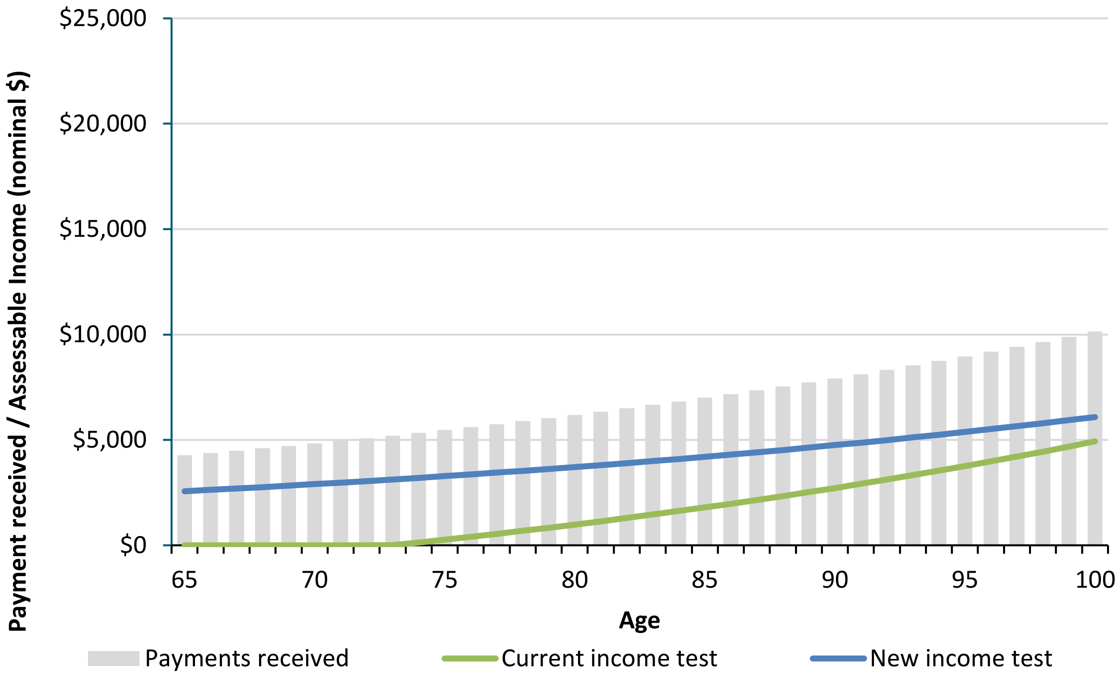
Assessing 60 per cent of payments as income produces sustainable social security outcomes across retirement at various levels of savings. Recipients of social security pension payments who allocate a proportion of their superannuation savings to a lifetime product are expected to experience broadly similar outcomes under the income test in the early years of retirement, compared to if they held their savings in an account-based income stream drawn down at the minimum regulated rate. This helps ensure that people will not be unfairly disadvantaged by making use of a lifetime product, compared to outcomes for the most common superannuation retirement product.

Payments from pooled lifetime products consist of the gradual return of the initial investment amount in nominal terms (the 'return of capital'), earnings on the pooled savings, and 'mortality credits' from members who, upon their death, contribute to the ongoing payments to other members. The proportion that each of these components contributes to product payments will vary at different points in time and with the design of different products.

Assessing 60 per cent of payments as income recognises that, across retirement, a portion of payments are the return of a person's original capital investment, and are therefore not income.

The difference between the current and the new income test treatment is shown for a lifetime annuity in Chart 2 below.

Chart 2: Income test for lifetime annuity – current v. new[4]



[4] Lifetime annuity assumes purchase by a 65 year old male. Payments are indexed to inflation annually, with the purchaser receiving a payment of $4,272 in the first year.

Assets Test

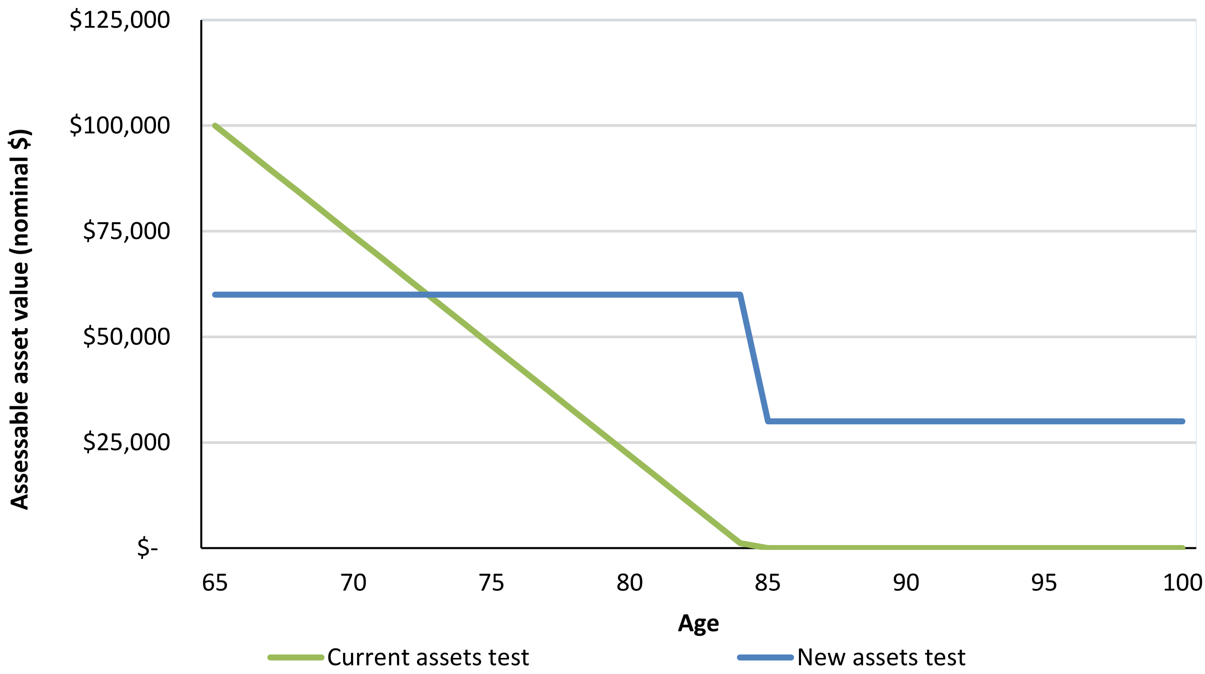
Assessing 60 per cent of the purchase price (in nominal terms) recognises that people who have committed to pooling their savings in a lifetime product cannot flexibly draw on those assets for self-support, and have committed these funds to the stream of income that the product provides. It better aligns the withdrawal of social security payments under the assets test with these payments.

It results in more favourable asset test outcomes in early years compared to the current rules and asset test outcomes for an account-based income stream. Compared to the current means test rules for lifetime products, assessing 60 per cent of the nominal purchase price until the threshold day balances this up-front concessionality with a more consistent asset test assessment over time. This will help to target income support assistance more effectively over time, particularly at higher levels of assessable assets. Maintaining this asset value until the threshold day also helps mitigate the risk of lifetime products being used to shield assets from assessment or maximise Age Pension payments by assessing a more consistent amount over time (compared to the current rules).

After the threshold day, the assessable asset value will be reduced to 30 per cent. This helps address the risk of punitive asset test outcomes later in life while still recognising an asset value for the product. This is appropriate for a product intended to provide retirement income for life.

The difference between the current and the new assets test treatment is shown for a lifetime annuity in Chart 3 below.

Chart 3: Assets test for lifetime annuity – current v. new[5]



[5] Lifetime annuity assumes purchase by a 65 year old male. Payments are indexed to inflation annually, with the purchaser receiving a payment of $4,272 in the first year.

SCHEDULE 1 – LIFETIME INCOME STREAMS

Determination of purchase amount

The purchase amount is used to determine the purchase price of an asset-tested income stream (lifetime). The purchase amount is the sum of:

- amounts paid for the income stream before the assessment day, compounded up to the assessment day, and
- amounts paid for the income stream after the assessment day.

The formula used to compound amounts paid for the income stream before the assessment day has been adapted from the *Income Tax Assessment Regulations 1997*, regulation 307.205.02C, which is used to determine the value of deferred income streams for tax purposes. The amounts are compounded annually by the upper deeming rate.

Determining the purchase amount in this way means that products with very long deferral periods are not unfairly advantaged by the new means test rules. It also means that recipients with products paid for in multiple instalments receive similar outcomes to those with products paid for in one instalment.

In certain circumstances, a power rests with the Secretary to determine the purchase amount of certain income streams. This power will be used if products fail and the purchase amount needs to be adjusted. It will also be used for products such as collective defined contribution schemes, where there is not a direct relationship between amounts paid and the value of the income stream.

The treatment of collective defined contribution schemes has previously been made clear by the Department. The purchase amount of a collective defined contribution schemes (CDCs) will be valued in a similar way to how they would be valued for the tax purposes, which is specified in regulation 307.205.02D of the *Income Tax Assessment Regulations 1997*.

As there are currently no CDCs in Australia, we do not have the information at this time to carve out legislatively the treatment of CDCs separate from the treatment of other lifetime income streams. Once a CDC is in development, and we have more details, we will be able to enact the legislative instrument detailing the specific treatment of CDCs using the instrument making power contained in section 1120AB (7) of the Bill.

Assessment prior to retirement

The new means test rules are designed for products held by recipients in retirement. The ability for income stream payments to be deferred raises issues as to when a product should be assessed under the new rules. As such, there are provisions in the Schedule around when to assess a product under the new rules (the assessment day), and how it should be assessed prior to that point.

These rules also have regard to existing policy around when to assess superannuation assets held by a person. For social security purposes, superannuation is generally not assessed under the means test until the person reaches pension age, unless a recipient purchases a product with their superannuation that makes payments before pension age.

SCHEDULE 1 – LIFETIME INCOME STREAMS

The new rules balance this treatment with the provisions in the new superannuation regulations that allow for payments to be made from an income stream once the person has met specified conditions of release. This is often before pension age.

For lifetime income streams purchased with superannuation monies, the assessment day is the later of:

- the day the first amount was paid for the income stream
- the day the income stream was acquired (where no amount is identifiable as having been paid for the income stream), and
- the day the person meets a specified 'condition of release'.

The specific conditions of release will be outlined in a notifiable instrument. They will be the same conditions of release used in sub-regulation 1.06A(3)(a) of the *Superannuation Industry (Supervision) Regulations 1994* that determine when a payment can be made to the primary beneficiary of the income stream.

Before this day, products purchased with superannuation monies will not be assessed under the means test.

For lifetime income streams purchased with non-superannuation monies, the assessment day is the earlier of:

- the day the product starts making payments, and
- the later of:
  - the day the first amount was paid for the income stream
  - the day the income stream was acquired (where no amount is identifiable as having been paid for the income stream), and
  - the day the person reaches pension age.

Before this day, products purchased with non-superannuation monies will be assessed as managed investments. Under the income test, the purchase amount will be deemed as per the social security income test deeming rules. Under the assets test, the full purchase amount will be assessed.

Reversionary beneficiaries

Where a recipient is the reversionary beneficiary of a lifetime income stream, there are additional provisions to maintain the continuity of the assets test assessment. If the original owner of the income stream had reached their assessment day, then the threshold day that was calculated for that original owner applies to the reversionary beneficiary. If the original owner had not reached their assessment day, then the threshold day is calculated based on the age of the reversionary beneficiary.

The calculation of a reversionary beneficiary's assessment day has also been made clear in the legislation. It is similar to the calculation for the original owner, with small changes to reflect the nature of the way they obtained the product.

Products with high surrender values or death benefits

An income stream can be sold outside of superannuation, where it is not bound by the new superannuation regulations. Income streams not bound by the superannuation regulations can have high death benefits and surrender values. This can make the product more available to be used for self-support.

The proposed new rules include provisions to support the integrity of the social security means test in such situations. Where products offer surrender values or death benefits above the limits imposed by the capital access schedule in the new regulations, the assets test will assess the maximum value of:

- the amount determined under the proposed new rules (60 per cent of the purchase price to the threshold day, and then 30 per cent);
- any current or future lump sum amount that is payable if a person withdraws from the product that is above the limits in the capital access schedule; or
- any current or future death benefit payable under the product that is above the limits in the capital access schedule.

Investment-type life insurance products

Some life insurance products sold to retirees are functionally similar to the death benefits that can be attached to lifetime income streams. With the amendments to the treatment of death benefits (outlined above), similar amendments need to be made to the treatment of these life insurance products.

The asset value of life insurance products for the purposes of social security assets test will be the greater of the surrender value at any given day, and the purchase price of the product, if it:

- was purchased after the person reached the Age Pension age, and
- the sum of the amounts paid for the product in any 12 month period is greater than 15 per cent of benefits payable upon death.

The second criterion ensures that the new rules only apply to investment-type life insurance products, which act similarly to term deposits. Standard premium-based life insurance products will not be affected.

Without this amendment, two retirees could purchase products that provide similar benefits, but would receive very different means test outcomes. This would make the new means test rules less effective at targeting income support to those who need it most.

Products held inside an account-based income stream

Lifetime products can be held as an investment *inside* an account-based income stream. Where this occurs, the value of the lifetime product will be separated from the value of the account-based income stream, and assessed separately.

The definition of asset-tested income stream (lifetime) provides for the Secretary of the Department of Social Services to determine via legislative instrument to what extent a product is an asset-tested income stream (lifetime), to account for these situations.

Grandfathering

Where retirees have already purchased lifetime products prior to implementation of the new rules, grandfathering these investments recognises that these are long-term products, purchased with the expectation that they would be assessed under the existing rules. This will ensure fairness for policy holders and will also be appropriate for the providers of these income stream products.

As such, the new means test rules will only impact those who purchase a lifetime income stream or an investment-type life insurance product after 1 July 2019.

People who have purchased a lifetime income stream or an investment-type life insurance product before 1 July 2019 will not be impacted by the new rules for these products. They will continue to be assessed under the existing rules.

Expected Impacts

The numbers affected and the cost of the new rules were modelled by the Australian Government Actuary and approved by the Department of Finance. They are based on social security data and available information on the future of the income stream market in Australia.

Modelling on the impacts of the new rules, conducted by the Australian Government Actuary, was released by the Department on DSS Engage in July 2018.[6]

Numbers affected

Consideration has been given to how both current and new pensioners will be impacted by the new means test rules.

Take up of new lifetime income stream products by current pensioners is expected to be very low. This is because it is very uncommon for pensioners to change retirement income products once in retirement.

Take-up of new lifetime income stream products by new pensioners is expected to be modest. While they may become more common in time, there are currently very few products on the market for retirees to purchase.

Modelling was limited to pensioners with superannuation assets. Pensioners without superannuation assets are very unlikely to purchase one of these products, as the future development of these products is expected to occur almost exclusively within superannuation.

This modelling is sensitive to developments in the income stream market and the individual circumstances of current and new pensioners. As existing pensioners who hold these products will not be affected, the modelling is only an estimation of the impacts of the new rules. It does not reflect the exact number of actual pensioners who will be affected by the change – such a number is not possible to know, as it is dependent on pensioner behaviour.

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[6] Department of Social Services 2018, *Summary of modelling results for the new means test rules for pooled lifetime retirement income streams*, https://engage.dss.gov.au/wp-content/uploads/2018/07/Final-Modelling-Summary-Results-Document-July-2018_0.pdf

A summary of the number of pensioners estimated to be affected by the new rules is at Table 1 below.

Table 1: Estimated number of pensioners (DSS & DVA) impacted by new means test rules

	2019-20	2020-21	2021-22
Current pensioners[1]	206	505	1,000
New pensioners	819	2,009	3,496
Total	**1,025**	**2,514**	**4,496**

[1] Current pensioners who take out a lifetime income stream product after the new rules are implemented. Current pensioners who hold a lifetime income stream product prior to the introduction of the new rules will not be affected.

Financial impact

The cost of the new rules was determined by comparing how much pension the estimated number of impacted pensioners would have received under the existing rules for lifetime income streams, and how much they will receive under the new means test rules.

It is important to note that the new means test rules are designed to better reflect the lifetime nature of these products. As such, the income and assets test assessment of these products is 'smoother' over retirement when compared to the existing rules –there are fewer sudden increases and decreases in assessable income and assets, which results in fewer sudden increases and decreases in pension.

Across a person's retirement, it is expected that the total pension paid to a person will be similar to the pension that would be paid under the current rules.

In individual years, however, pensioners may receive more or less pension than they would have under the existing rules, depending on their circumstances and the particular lifetime income product they purchase.

In particular, the new means test rules assess a lower asset value under the assets test in the first years of retirement when compared to the existing rules. This results in a small upfront budgetary cost for the new means test rules. This budgetary cost is balanced later in retirement.

The impact of the new means test rules on payments is outlined below in Table 2.

Table 2: Impact of new means test rules on payments

	2019-20	2020-21	2021-22	Total
Social Services	$0.8m	$1.7m	$2.8m	$5.3m
Veterans' Affairs	$0.0m	$0.1m	$0.1m	$0.2m
Total	**$0.8m**	**$1.8m**	**$2.9m**	**$5.5m**

The total cost announced in the Budget for the new means test rules was $20.2 million across the forward estimates. The majority of this cost is for the Department of Human Services and the Department of Veterans' Affairs to update their systems and public information to reflect the changes.

The administrative cost to implement the new means test rules is outlined in Table 3 below.

Table 3: Administrative cost to implement the new means test rules

	2018-19	2019-20	2020-21	2021-22	Total
Social Services	-	$0.2m	$0.2m	$0.2m	$0.7m
Veterans' Affairs	$1.1m	$0.0m	$0.0m	$0.0m	$1.2m
Human Services	$9.8m	$1.2m	$0.9m	$0.9m	$12.8m
Total	**$10.9m**	**$1.4m**	**$1.1m**	**$1.1m**	**$14.7m**

Consultation

A range of stakeholders (including financial product providers, academics, commercial and industry superannuation funds, and seniors' rights organisations) were consulted in developing the new rules.

Stakeholder consultation on the new means test rules commenced in early 2017 with a public discussion paper detailing potential avenues for reform. The Department used its existing stakeholder networks, and the networks of the Treasury, to let potentially interested parties know about the consultation. 17 stakeholder submissions were received on the discussion paper.

Following stakeholder feedback on the discussion paper, an early version of the new rules was developed. A position paper, outlining these proposed rules and presenting modelling of their impacts, was publicly released by the Department on 16 January 2018. In addition to the paper being publicly available, the Department and the Treasury informed previously consulted stakeholders of the consultation. 26 stakeholders made submissions to the position paper.

The Department also held in-person round tables on the new means test rules in Sydney and Melbourne on 12 and 13 February 2018. 19 organisations were represented at the round tables.

The Government incorporated stakeholder feedback into the design of the final new means test rules, which were announced in the 2018-19 Budget.

During the legislative drafting process, previously consulted stakeholders were invited to comment on an exposure draft of the legislation. 26 previously consulted stakeholder organisations requested to receive the draft legislation and related documents. Comments on the draft legislation was open from 19 October 2018 to 7 November 2018. Comments were received from 17 organisations.

A detailed list of consulted stakeholders is at **Attachment A**.

Schedule 2 – Pension Work Bonus

Background

The Work Bonus is an income test concession for social security pensioners of Age Pension age and Department of Veterans' Affairs pension recipients of qualifying age.

The Work Bonus is currently $250 per fortnight. This means that the first $250 of fortnightly employment income is not counted under the pension income test. Any unused part of the Work Bonus accrues to a current maximum used concession balance of $6,500, and can be used to exempt future employment income earnings.

The Work Bonus applies in addition to the fortnightly income test free area of $172 for single pensioners and $304 (combined) for pensioner couples. This means a single age pensioner, with no other income, can currently earn up to $422 a fortnight from employment without affecting their pension.

Currently, the Work Bonus only applies to employment income, which is defined in the Social Security Act as income earned from remunerative work undertaken by a person in an employer / employee relationship. Accordingly, pensioners who are self-employed do not currently benefit from the Work Bonus.

Rationale

From 1 July 2019, this Schedule increases the Work Bonus from $250 to $300 per fortnight and the maximum unused concession balance from $6,500 to $7,800.

It also extends the application of the Work Bonus to all income from gainful work that involves personal exertion. This includes earnings from self-employment such as work undertaken as an independent contractor or consultant.

Rationale for increasing the Work Bonus

The Work Bonus was set at $250 in 2011 and has not been increased since. Increasing the Work Bonus to $300 per fortnight, and the maximum unused concession balance to $7,800, will help maintain the value of the Work Bonus concession and mean that eligible pensioners will get more benefit from working.

Rationale for extending the Work Bonus

Extending the application of the Work Bonus to include all earnings from gainful work that involves personal exertion will improve the consistency and equity of the Work Bonus arrangements.

This will mean that self-employed pensioners who earn income from an actual engagement in gainful work will be able to access the Work Bonus in the same manner as pensioners who have earnings as an employee.

The Schedule includes a 'personal exertion' test to ensure the Work Bonus is only available to self-employed people who earn income from an actual engagement in gainful work. It is not intended that the Work Bonus will apply to income earned through business structures associated with the return on financial or real estate investments.

Expected Impacts

Numbers affected

Overall, about 88,750 social security pensioners and 1,000 allowance recipients will receive an increase in their payments from 1 July 2019 and about 1,150 people will become eligible for a social security pension for the first time. Around 3,000 Veterans' Affairs pensioners will also benefit. Around 14,000 of these pensioners and recipients will benefit from both the increase in the Work Bonus and the extension of the Work Bonus to earnings from self-employment.

- Increasing the Work Bonus to $300 a fortnight will benefit about 81,500 social security pensioners and 850 allowance recipients each fortnight by an average of $16 a fortnight. About 450 people will also become eligible for a social security pension for the first time at an average rate of about $34 a fortnight. Around 1,400 Veterans' Affairs pensioners will benefit from increasing the Work Bonus by an average of about $24 a fortnight.

- Extending eligibility to the Work Bonus to earnings from self-employment will benefit an estimated 21,250 social security pensioners and 200 allowance recipients each fortnight. For the self-employed, the average benefit will be about $80 a fortnight. About 700 people will also become eligible for a social security pension for the first time at an average rate of about $130 a fortnight. Around 1,650 self-employed Veterans' Affairs pensioners will benefit by an average of about $60 a fortnight.

Financial impact

The total cost announced in the Budget for the increase and extension of the Work Bonus was $227.4 million over the forward estimates. The majority of this cost is increased social security and veterans' affairs payments. There is also a revenue save associated with the change; these savings occur because as the Age Pension is taxable, an increase in pension payments also results in an increase in tax revenue.

The impact of increasing and extending the Work Bonus on payments is outlined below in Table 4.

Table 4: Impact of increasing and extending the Work Bonus on payments

	2019-20	2020-21	2021-22	Total
Social Services	$83.5m	$86.3m	$85.8m	$255.6m
Veterans' Affairs	$3.5m	$3.2m	$2.9m	$9.7m
Treasury	-	-$20.0m	-$23.0m	-$43.0m
Total	**$87.0m**	**$69.5m**	**$65.7m**	**$222.3m**

The Department of Human Services and the Department of Veterans' Affairs will also incur administrative costs to update their systems, produce public information about the changes and collect information from self-employed pensioners about their eligibility for the Work Bonus. There is also a small administrative cost for the Administrative Appeals Tribunal (AAT).

The administrative cost to implement the increase and extension of the Work Bonus is outlined in Table 5.

Table 5: Administrative cost to implement the increase and extension of the Work Bonus

	2018-19	2019-20	2020-21	2021-22	Total
Human Services	$3.4m	$0.5m	$0.2m	$0.2m	$4.1m
Veterans' Affairs	$0.7m	$0.1m	$0.1m	$0.1m	$0.9m
AAT	-	$0.0m	$0.0m	-	$0.0m
Total	**$4.1m**	**$0.6m**	**$0.3m**	**$0.3m**	**$5.0m**

Schedule 3 – Pension Loans Scheme

Background

The Pension Loans Scheme (PLS) was first introduced in 1985 (targeted only to assets tested pensioners of Age Pension age). It was expanded in 1996 to income tested pensioners of Age Pension age and those self-funded retirees precluded from pension due to either the income or assets tests, but not both.

The Scheme is voluntary and provides a reverse mortgage type loan paid as a fortnightly income stream (unlike most commercial reverse mortgage schemes that offer a line of credit or lump sum). An eligible person can borrow an amount which increases their fortnightly pension up to the maximum rate of fortnightly pension including the pension and energy supplements.

A PLS loan is secured against real estate owned by the person in Australia. The loan is subject to an interest rate set by the Minister for Social Services. The interest rate is 5.25 per cent.

A PLS loan can be repaid at any time and will normally be recovered when the secured real estate is sold or from the person's estate.

The Australian Securities and Investments Commission (ASIC) has advised that the existing PLS is not subject to the National Credit Code as PLS loans are established by statute rather than contract.

There are around 640 active loans in the existing Scheme.

Rationale

The expansion of the PLS will allow more older Australians to access the equity in their homes and improve their standard of living.

From 1 July 2019, the PLS will be expanded to include all people of Age Pension age who own securable real estate in Australia. This will mean that for the first time, maximum rate pensioners of Age Pension age and those self-funded retirees precluded from participating in the existing Scheme, will be able to obtain a loan.

To facilitate the expansion of the Scheme the income and assets tests will no longer be applied and the maximum fortnightly amount of pension plus loan will increase from 100 per cent to 150 per cent of the maximum rate of fortnightly pension including the pension and energy supplements.

Expected Impacts

Numbers affected

It is estimated that around 6,000 older Australians will take-up a loan during the first three years of the expanded Scheme.

The expansion of the Scheme will also allow loan recipients under the existing Scheme to increase their amount of fortnightly loan, should they wish to. An estimate of the take-up for this cohort has not been made.

Impact of Pension Loans Scheme loans on access to aged care

Most people receiving a loan under the PLS secure the loan against their principal home.

In cases where the person does not occupy their principal home (then referred to as their 'former principal home') but it is still occupied by a 'protected person' (the person's spouse, partner or dependent child), it continues to be exempt from the aged care means test.

Once the home is not occupied by the person or their spouse, partner or dependent child, the value of the home will be included in the aged care means test.

However, the value included as an asset is capped. As at 20 September 2018, the value of the cap is $166,707.20. This amount changes in line with changes to the Age Pension in March and September each year.

The aged care means test assessment considers net assets. Consistent with the assets test rules for Age Pension, the value of an asset is reduced by any charge, encumbrance or liability held over that asset. When calculating the net value of a person's real estate assets any loan under the PLS held against the property is taken into consideration. If the net value of a care recipient's former principal home is less than the home exemption cap because of a loan under the PLS or another charge, encumbrance or liability is held over the asset, the net value is included in the aged care means test assessment.

If a person uses an investment property as security for the PLS the value of the investment property less the PLS loan will be included in the aged care means test.

It is also important to consider that while a person who has accessed the PLS may have less equity in the secured property their overall financial position will have been impacted due to the receipt of the loan payments.

It is also relevant to consider that recipients who access a commercial reverse mortgage product have similar impacts on their net real estate equity for the purposes of the aged care means test.

Financial impact

Constraints on the maximum loan that can be accrued

Apart from the limit of fortnightly amount of loan that can be borrowed, the PLS includes a formula, developed by the Australian Government Actuary, that helps protect the interests of the person and the Commonwealth, by limiting the amount of cumulative loan debt.

The formula operates like a loan-to-value ratio and has regard to the person's age and the value of their real assets offered as security.

The Department of Human Services administers the PLS and reviews each loan on an annual basis.

Increase in the maximum pension plus loan

Table 6 below shows the potential increase in a person's maximum pension plus loan under the scheme, if they choose to take the maximum amount available under the PLS.

Table 6: Increase in the maximum pension plus loan[7]

	Single			Couple (per person)		
	100%	150%	Increase	100%	150%	Increase
Fortnightly	$916.30	$1,374.45	**$458.15**	$690.70	$1036.05	**$345.35**
Annually	$23,823.80	$35,735.7	**$11,911.90**	$17,958.20	$26,937.30	**$8,979.10**

PLS loans do not impact Government expenditure as they are a loan issued at a market rate which is expected to be fully repaid. The $11 million cost across the forward estimates announced at Budget relates to administrative costs for the Department of Human Services and the Department of Veterans' Affairs to update their systems, and produce public information about the changes, marginally offset by the interest accrued on the loans under the expanded scheme.

[7] Rates of pension as at 20 September 2018. Rates of pension will change prior to commencement of the measure on 1 July 2019, due to indexation.

Schedule 4 – Other Amendments

Background

The 'employment nil rate period' provisions operate beneficially. They allow an income support recipient whose social security pension or benefit is not payable because of employment income to immediately return to payment if the work ceases within 12 weeks, provided they still meet all other qualification requirements for that payment.

During employment income nil rate periods, the recipient is also considered to be receiving a social security pension or benefit for certain purposes, including retaining their Health Care Card or Pensioner Concession Card.

Rationale

This Schedule makes technical amendments to confirm that income support recipients over Age Pension age qualify for the 'employment nil rate period' provisions.

Income support recipients over Age Pension age were given access to the employment nil rate period provisions as part of Pension Reform changes in September 2009. However, this access was not correctly reflected in the Social Security Act.

This Schedule will make technical amendments to the Social Security Act to confirm that income support recipients over Age Pension age may qualify for the employment income nil rate period provisions.

Expected Impacts

There will be no impact from this change as income support recipients over Age Pension age have been allowed to access to the employment nil rate period provisions since September 2009.

The employment income nil rate period provisions are entirely beneficial and the changes made by this Schedule will not adversely impact any individual.

ATTACHMENT A

Attachment A – Details of Consultation Processes for Schedule 1

Submissions to Discussion Paper

Consultation Period: 10 February 2017 – 10 March 2017

A discussion paper on the social security means testing of retirement income streams was released on the Department of Social Services' consultation platform, DSS Engage, on 10 February 2017. Responses to the paper were accepted up to close of business 10 March 2017.

17 submissions were made in response to the Discussion Paper.

8 submissions were made in confidence.

The remaining 9 public submissions were made by:

- The Association of Superannuation Funds of Australia (ASFA)
- Australian Institute of Superannuation Trustees (AIST)
- Challenger Limited[8]
- Committee for Sustainable Retirement Income
- Council on the Ageing (COTA Australia)
- Financial Services Council (FSC)
- First State Super
- 1 private citizen

The public submissions to the discussion paper can be accessed on engage.dss.gov.au.

[8] Challenger Limited submitted two submissions to the 2017 Discussion Paper.

ATTACHMENT A

Stakeholder Round Tables

Sydney – 12 February 2018

Melbourne – 13 February 2018

The Department of Social Services hosted stakeholder workshops on the new means test rules for pooled lifetime income streams in Sydney and Melbourne on 12 and 13 February 2018 respectively.

The following 19 organisations were represented at the stakeholder workshops:

- AMP
- The Association of Superannuation Funds of Australia (ASFA)
- The Australian Government Actuary
- The Australian Institute of Superannuation Trustees
- The Australian Prudential Regulation Authority
- The Australian Securities and Investments Commission
- Challenger Limited
- Comminsure
- Committee for Sustainable Retirement Incomes
- Financial Services Council (FSC)
- First State Super
- Industry Super Australia
- King & Wood Mallesons
- Mercer
- Mine Super
- SunSuper
- TAL
- The Treasury
- UniSuper Management Pty Ltd

ATTACHMENT A

Submissions to Position Paper

Consultation Period: 16 January 2018 – 16 February 2018

A position paper on the social security means testing of lifetime retirement income streams was released on DSS Engage on 16 January 2018. This position paper outlined the proposed structure of the new means test rules, and modelling to support the proposed position. Responses to the paper were accepted up to close of business 16 February 2018.

26 submissions were made in response to the Position Paper.

10 submissions were made in confidence.

The remaining 16 public submissions were made by:

- The Actuaries Institute
- The Association of Superannuation Funds of Australia (ASFA)
- AustralianSuper
- Australian Institute of Super Trustees (AIST)
- Challenger
- Construction and Building Industry Super (CBUS)
- Council on the Ageing (COTA Australia)
- First State Super
- Financial Services Council (FSC)
- Industry Super Australia
- Mercer
- Mine Super
- Retirement Essentials
- Rice Warner
- UniSuper Management Pty Ltd
- 1 private citizen

The public submissions to the position paper can be accessed on engage.dss.gov.au.

ATTACHMENT A

Submissions on Draft Legislation

Consultation Period: 19 October 2018 – 7 November 2019

The draft legislation establishing the new means test rules for pooled lifetime income streams was released to limited stakeholders under a deed of confidentiality. Invitations to participate were sent on 19 October 2018. Responses to the draft legislation was accepted up to close of business 7 November 2018.

20 previously consulted stakeholders and the ATO Superannuation Industry Stewardship Group (ATO SISG) were sent deeds of confidentiality, inviting them to participate in the private consultation. This included the members of peak bodies such as the Financial Services Council (FSC) and the Association of Superannuation Funds of Australia (ASFA).

Signed deeds were returned by 26 stakeholder organisations, who were sent the draft legislation and related documents for consultation.

Comments on the legislation were received by 17 organisations. Comments were received in confidence.