

**SUBMISSION BY THE DEPARTMENT OF FAMILY AND COMMUNITY SERVICES TO
THE SENATE COMMUNITY AFFAIRS LEGISLATION COMMITTEE**

**FAMILY AND COMMUNITY SERVICES AND VETERANS' AFFAIRS LEGISLATION
AMENDMENT (INCOME STREAMS) BILL 2004**

Introduction

The Family and Community Services and Veterans' Affairs Legislation Amendment (Income Streams) Bill 2004 gives effect to two measures announced earlier this year in the Government's Statement "*A more flexible and adaptable retirement income system*". These measures change the social security and veterans' affairs means test assessments of income streams to:

- provide a 50% assets test exemption for a new product, 'market-linked income streams' from 20 September 2004; and
- change the assets test concession from 100% to 50% for certain non-commutable income streams purchased from 20 September 2004.

The Bill also contains amendments to:

- align the characteristics of existing life expectancy income streams products with those of the new market-linked income stream product; and
- increase the guarantee period for asset test exempt lifetime income stream products.

These measures and amendments are discussed in more detail below.

The Income Streams Environment

The diagram at Attachment A gives a pictorial representation of the different categories of income streams products. In broad terms, superannuation benefits can be taken either as a lump sum, income streams or a mix of both. An income stream arises where a sum of money is exchanged for the right to a series of income payments in the future. Income stream products comprise two main categories:

1. Commutable (non-complying) income streams, which are those income streams that do not qualify for the social security asset test exemption (s.9A or s.9B of the Social Security Act) and the tax-related Pension Reasonable Benefit Limit (RBL). Allocated income streams are a non-complying income stream and are the most popular of the income stream products.
2. Non-commutable (complying) income streams are those that do qualify for the RBL and the asset test exemption. This means that the asset value of the income stream is not taken into account when determining a person's eligibility for a social security payment. These incentives are provided to encourage take-up of income streams that have desirable characteristics from a retirement income policy perspective (e.g. non-commutable, steady drawdown of income).

Income streams can also be grouped into insurance-based products and non-insurance. The insurance-based products involve guaranteed payments, while the non-insurance-based products do not guarantee payments. That is, for non-insurance products the purchaser bears the investment risk while for insurance products the insurer bears the investment risk (although the pricing of these products will reflect the risk borne by the insurer).

The changes proposed by the Government will increase competition in the income streams market and provide retirees with more choice by making available a wider range of income stream products that best meets their retirement needs. These changes will also make the retirement income system fairer by better targeting the age pension to those in need.

Market-Linked Income Streams

The extension of concessional assets test status to the new 'market-linked income streams' is intended to increase competition in the provision of income stream products. Consumers will benefit from having greater choice in selecting an income stream that best meets their retirement needs. Market-linked income streams will offer market returns but the purchaser will not be able to withdraw his or her capital before the term of the product has ended (that is, it is non-commutable).

Currently insurance-based income streams, because they provide stable income payments over a guaranteed period, are given concessional tax and social security assets test treatment. Consumers can only select a product that offers a guaranteed but generally low return. The market linked income stream will offer potentially higher, but more variable market returns.

Individuals who prefer greater predictability regarding the income they receive will continue to be able to purchase the existing range of complying income stream products.

Other characteristics of the market linked income streams product include changes that will provide greater choice, more flexibility and the capacity to purchase a product for a term exceeding their own life expectancy:

- The product's term will be between the individual's life expectancy and life expectancy at an age five years younger than that person's current age. Individuals who are members of a couple will also have the choice of selecting the term based on their spouse's life expectancy and life expectancy of that partner at an age five years younger.
 - Allowing retention of the assets test exemption on reversion to a spouse, if the primary beneficiary dies, provides couples with greater choice in purchasing income streams that provide income for the greater part of both partners' lives.
- Payments must be made to the recipient annually and are based on payment factors contained in the Superannuation Industry (Supervision) Regulations.
- The product will be non-commutable except in limited circumstances, such as hardship or divorce.
- Individuals will be able to purchase market-linked income stream products from any age and obtain the 50 per cent asset test concession from purchase.
 - Currently lifetime income streams are granted an asset test concession from purchase, and these changes will ensure greater consistency across all asset test exempt products.

The greater flexibility and choice, provided by allowing a person to choose a term longer than life expectancy and the ability to purchase the product with a concession before age pension age, will also be extended to the existing life expectancy income streams.

Changing The Asset Test Exemption To 50%

Social security payments are targeted to those most in need through the assets and income tests. These are collectively known as 'the means test'. The means test is the fairest way to ensure that the limited taxpayer funds available for social security expenditure go to those in greatest need.

The assets test is based on the principle that people with substantial assets apart from their home should use those assets either directly or to produce income to meet day to day living expenses before calling upon community resources for income support through the social security system. The current assets test thresholds (as at 20 March 2004) are provided in the tables below.

Chart A - Assets Test for Homeowners:

Family situation	For full pension/allowance	For part pension
Single	up to \$149 500	less than \$306 250
Partnered (combined)	up to \$212 500	less than \$473 000
Illness separated couple (combined)	up to \$212 500	less than \$526 000
One partner eligible (combined)	up to \$212 500	less than \$473 000

Chart B - Assets Test for Non-homeowners:

Family situation	For full pension/allowance	For part pension
Single	up to \$257 500	less than \$414 250
Partnered (combined)	up to \$320 500	less than \$581 000
Illness separated couple (combined)	up to \$320 500	less than \$634 000
One partner eligible	up to \$320 500	less than \$581 000

The change in the assets test exemption from 100% to 50% for 'purchased' asset test exempt income streams is intended to ensure that the age pension is paid to those who need it most. A 50% exemption retains a significant incentive for individuals to purchase income streams. For example:

- even after the commencement of the change, it will be possible for home owner couples to invest \$900,000 in a complying income stream and still receive some age pension if they have no other assessable assets; and
- a home owner couple can receive the full pension if they have up to \$425,000 invested in a non-commutable income stream and they have no other assessable assets.

This exemption is significant when compared to average asset holdings of age pensioners and the average superannuation payout.

- The average new claimant accessing the age pension has assets of \$75,000 including superannuation (but not including their principal home).
- Treasury's Retirement Income Modelling Unit has estimated that average superannuation payouts for the Australian population will be \$83,000 in June 2005 and \$100,000 in June 2010.

All assets test exempt income streams purchased before 20 September 2004 will continue to receive a 100% assets test exemption. This means that no current customers will be affected by this change. The income test does not change. Income streams that qualify for the 50 per cent exemption from the assets test, which includes market-linked income streams, will be assessed in the same way under the income test as existing asset test exempt income streams.

Aligning The Characteristics Of Life Expectancy Income Streams Products With Market-Linked Income Stream Products

Allowing a person to choose a term longer than life expectancy and the ability to purchase the product with a concession before age pension age, will increase the flexibility and attractiveness of life expectancy income stream products. It will also facilitate greater choice by enabling individuals to more easily and accurately compare the respective merits of each product when making their retirement decisions.

Increasing The Guarantee Period For Asset Test Exempt Lifetime Income Streams

The current means test rules stipulate that an asset test exempt lifetime income stream may only be commuted if the primary beneficiary dies within a 10 year period of purchasing the income stream. The Bill will extend this period to allow a lifetime income stream to be commuted provided the primary beneficiary dies within a period equal to his or her life expectancy or within 20 years of purchasing the income stream, whichever is the lesser.

The guarantee period allows some capital to be paid to the recipient's estate in the event of premature death.

This is another initiative to provide individuals with greater choice in meeting their retirement needs by increasing the attractiveness of asset test exempt lifetime income streams.